S. HRG. 109–878

OVERSIGHT OF THE IMPLEMENTATION OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

DECEMBER 6, 2006

Serial No. J–109–123

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

34–119 PDF WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON THE JUDICIARY

ARLEN SPECTER, Pennsylvania, *Chairman*

ORRIN G. HATCH, Utah
CHARLES E. GRASSLEY, Iowa
JON KYL, Arizona
MIKE DEWINE, Ohio
JEFF SESSIONS, Alabama
LINDSEY O. GRAHAM, South Carolina
JOHN CORNYN, Texas
SAM BROWNBACK, Kansas
TOM COBURN, Oklahoma

PATRICK J. LEAHY, Vermont
EDWARD M. KENNEDY, Massachusetts
JOSEPH R. BIDEN, JR., Delaware
HERBERT KOHL, Wisconsin
DIANNE FEINSTEIN, California
RUSSELL D. FEINGOLD, Wisconsin
CHARLES E. SCHUMER, New York
RICHARD J. DURBIN, Illinois

MICHAEL O'NEILL, *Chief Counsel and Staff Director*
BRUCE A. COHEN, *Democratic Chief Counsel and Staff Director*

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

JEFF SESSIONS, Alabama, *Chairman*

ARLEN SPECTER, Pennsylvania
CHARLES E. GRASSLEY, Iowa
JON KYL, Arizona

CHARLES E. SCHUMER, New York
DIANNE FEINSTEIN, California
RUSSELL D. FEINGOLD, Wisconsin

WILLIAM SMITH, *Majority Chief Counsel*
PREET BHARARA, *Democratic Chief Counsel*

CONTENTS

STATEMENTS OF COMMITTEE MEMBERS

WITNESSES

SUBMISSIONS FOR THE RECORD

OVERSIGHT OF THE IMPLEMENTATION OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT

WEDNESDAY, DECEMBER 6, 2006

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Jeff Sessions, Chairman of the Subcommittee, presiding.

Present: Senators Sessions, Grassley, and Schumer.

OPENING STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM THE STATE OF ALABAMA

Chairman SESSIONS. Good afternoon. I am glad to see a good group here for this hearing.

Last year, after 8 calendar years and four Congresses of bipartisan cooperation and negotiation, needed reforms to the Bankruptcy Code were finally signed into law. I was proud to be an original cosponsor of those reforms, and Senator Grassley, who is with me today, was a prime original sponsor of it and led the fight for it, and very ably, I might add.

By the time it became law on April 20, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was no stranger to the Judiciary Committee or the Senate. Eleven Senate hearings had been held, and the Senate had passed similar bankruptcy reform four times—each time by strong bipartisan votes of 97–1, 83–14, 70–28, and 82–16. Similarly, the House had held a total of 18 hearings and passed bipartisan bankruptcy reform legislation on eight separate occasions.

Throughout the 8 years of debate, the underlying principles of the Act never changed. Fraud and abuse of the bankruptcy system were aggressively targeted so that the system could continue to provide bankruptcy relief for those truly in need. Individuals who were capable of paying back some or all of the money that they had borrowed would be asked to do so in exchange for receiving bankruptcy relief and protection. Individuals unable to pay back their debts because they "failed" to meet the means test would still be able to wipe out all of their debts. Creditors would have to fully disclose rates and repayment schedules and negotiate fairly with debtors trying to get back on their feet. Attorneys would be required to conduct a reasonable inquiry into their client's cases and would be held accountable for filing statements they knew to be false. Actually, that is a basic responsibility of attorneys, in my view, all along, to consult with their clients, but too often that has not been so in the bankruptcy processes.

If we had spent another 8 years drafting the Bankruptcy Act before passage, I do not think these underlying principles would have changed.

In short, the Act established a "means test" to effect needs-based bankruptcy and to determine whether a debtor should go into Chapter 7 bankruptcy, which is the complete discharge of all your debts, or Chapter 13 bankruptcy, where you enter into a repayment plan, based on the ability of that debtor to repay some or all of his debts. Each and every individual debtor has a chance to go before a judge to make his or her case and have considered unique or special circumstances that might impact the repayment ability.

The Act made clear that low-income debtors are not affected by the means test. Anyone whose household income is equal to or below the State average for a family of their size is exempt totally from the means test.

The Act gave unprecedented protections to women that are owed child support or alimony. Family support obligations are raised to a top-priority preference over all other debts. Before, they held seventh place in the tier of priorities. That means that child support and alimony debts need to be satisfied before other creditors. No longer will those who need the most have to wait the longest for funds to pay for food, shelter, and medical bills.

It limited the amount of assets debtors can shield from creditors through the purchase of expensive homes by lengthening the residency periods required to qualify for State homestead exemptions. We would have liked to have done more, but we made some progress, I believe, in that area.

It required full disclosure from credit card companies. Credit card issuers will now have to disclose interest rates and repayment terms in a clear and conspicuous way. This will help consumers make informed credit decisions. The Act also created new penalties against creditors who act in bad faith and gives debtors the ability to reduce the amount of debt owed to credit card companies if the credit card company refuses to negotiate an out-of-court settlement.

It required credit counseling for consumers in financial trouble who are considering bankruptcy. Additional financial education is required after filing for bankruptcy as a condition for discharging debts through the bankruptcy process. These provisions are extremely important, and I believe that if they are applied as intended, they will help significant numbers of people either avoid bankruptcy altogether and/or save their credit ratings.

It made Chapter 12 bankruptcy protections for small family farmers permanent. I know Senator Grassley was proud to see that finally occur. No longer will these great Americans have to wonder if the special protections which enable them to keep family farm that they have lived on for generations will be there when the crops do not come in.

Today's hearing will be one of general oversight—examining how the Act has been implemented since its general effective date of October 17, 2005, and examining how well the Act is working to date.

As a whole, it is probably too early to draw hard conclusions about all of the Act's effects, for we are still in the initial implementation phase. In fact, some of the Act's provisions, such as the provision requiring the Executive Office for U.S. Trustees to perform random audits on consumer bankruptcy petitions, became effective just a few months ago, October 20th.

Though it is still early, we do have some limited statistics indicating that the Act is working as intended: deterring fraud and abuse while preserving bankruptcy relief for those who truly need it. Today, among other things, we will learn the following:

Filings: Overall, consumer bankruptcy filings fell dramatically in the first few months following the passage of the Act, falling 65 to 70 percent, and are now trending only slightly upward. Recent filing levels are reaching a mere 40 percent of the pre-Act rates. Of course, we know some of that was the surge of filings that occurred before the new Act took place, but we do appear to be seeing some reducing in filings.

Chapter 13 filings: Early evidence suggests that Chapter 13 filings have risen, becoming a larger percentage of the total bankruptcy filings, from approximately 30 percent to 40 percent. This suggests that larger numbers of debtors able to pay back all or part of their debts are voluntarily filing under Chapter 13 rather than Chapter 7. I would just note that in my home State of Alabama, for reasons that lawyers tell me are quite justified, in the Northern District of Alabama, I believe it is 65 percent or more file under Chapter 13 and were doing that before this Act. Chapter 13 has some real advantages for the debtors, and so I think an increase in Chapter 13 filings has always been needed.

On the means testing question, conversions or dismissals from Chapter 7, the numbers collected by the U.S. Trustees now indicate that means testing is directly affecting less than 1 out of 100 files. A remarkable number.

Credit counseling: Preliminary estimates by the Department of Justice indicate that 10 percent of pre-filing counseling certificates are not being used immediately to file for bankruptcy, and they are good for 6 months. This indicates that people may be reconsidering their options.

So, in conclusion, my strong belief is that bankruptcy is entirely a Federal court responsibility and one that has a far larger impact on individuals and our economy than most people realize. I also believe that we, therefore, must monitor this Federal court system on a regular basis in order to stop abuses and eliminate unfairness. So I will pledge to work with my colleagues, Senator Schumer, who pretty soon I will be able to call "Chairman Schumer"—

Senator SCHUMER. It will not be the first time.

[Laughter.]

Chairman SESSIONS. It will not be the first time. We have played a little musical chairs, and you deserve some credit for achieving that, Mr. Chairman.

Senator GRASSLEY. Don't encourage him.

Chairman SESSIONS. Don't encourage him, Senator Grassley says.

[Laughter.]

Senator SCHUMER. I will say this: One of your colleagues on about October 1st offered me a free paid vacation to Hawaii for a month and a half.

Chairman SESSIONS. It would have been a bargain.

[Laughter.]

Chairman SESSIONS. Senator Schumer, it is great to serve with you. You are an excellent lawyer. You understand this issue, and I would recognize you at this time. And, Senator Grassley, I will recognize him because I know he has a 3 o'clock. You know, he chairs the Finance Committee and is one of the masters—

Senator GRASSLEY. No more because of him.

Chairman SESSIONS. You still do at this moment. And as one of the masters of the universe, he is going to have to go to a meeting to work out some last-minute issues.

STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator SCHUMER. Well, thank you. And I first want to thank you, Mr. Chairman, for being a gracious, courteous, and fair Chairman, very much appreciated, as I do Senator Grassley as a member of the Finance Committee as well. And at least as far as I am concerned, that fairness and courtesy will be reciprocated, so I thank both of you for that.

It is sort of interesting to note both my colleagues—and I do not agree with them on a whole lot of issues, but you respect people when they stick to their principles even if they are pushed the other way. And one of the issues that was before us in the Judiciary Committee was whether to fill up the Washington, D.C. circuit fully with 12 lawyers. And the position had been when Clinton was President that only 10 were needed, and both Senator Grassley and Senator Sessions, in particular, had advocated that. And then when the wheel turned, they stuck with that position, and that is something I will not forget and that I have great respect for. So, anyway, I thank both of you, and I suppose this happens. When I was in the House, Jim Sensenbrenner and I kept switching as Chair of the Crime Subcommittee, so I am sort of used to that.

Anyway, I want to thank you, and I thank you for holding this hearing. It comes at a time when many Americans are concerned about the high levels of personal debt in the country. Every holiday season, countless people, even those who typically pay off their credit card bills each month, borrow a little more and spend a little more. It is the holiday season, Christmas. Everybody wants to be nice to everyone in their family, and that is a great thing.

Just over a year ago, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act with the hope that it would eliminate fraudulent bankruptcy petitions. And as I often said while the bill was being debated, I share concerns with the bill's biggest supporters, especially with regard to abuse of our bankruptcy system by gamblers, hustlers, cheaters, and people who go into it simply with the idea of not paying their debts and sort of shirking them off. And that is not American and that is bad.

But I believe the bill that passed did not go far enough to ensure that those who have really suffered ruinous losses, often through no fault of their own and not any of the motivations mentioned in the previous paragraph, are able to try and get a new start. The so-called reform must distinguish between the reckless high roller and the single working mother or the hard-working breadwinner of the family who just becomes ill and loses his or her job.

All provisions apply to all debtors regardless of how they ended up bankrupt in the first place, and the immediate aftereffect of the passage of this bill was a rush to file that resulted in a record number of bankruptcy petitions last year. Since then, the number appears to have leveled off, but it is still too early to assess the actual success the bill has had in fulfilling its stated goals.

Here is what we do know. A number of studies have shown that the vast majority of individuals who filed for bankruptcy are in the second category. They file because of factors beyond their control: catastrophic medical problems, job loss, the death of a spouse, business failure. And in many cases, the petitioners actually experience multiple personal tragedies.

We also know that 60 percent of all credit card users—that is about 85 million Americans—carry a balance month to month and that the credit card companies are eager to go out of their way to target those who have recently emerged from bankruptcy. That I really do not like. There is too much preying, unscrupulous preying on those who are the most vulnerable consumers.

We know that at least three Federal courts have struck down certain provisions of the bill—or a single provision of the bill as unconstitutional. And we know from the testimony here and studies done that there is still a lot of unfairness in the system. So we need to make sure the bill is targeted at the Nation's cheats and not its cheated. And we did not do that as well as we might have in the previous bill.

For example, among the cheated are too many single- parent families in my home State and across the country who are worse off financially because a deadbeat mom or a deadbeat dad won't pay the child support. Those single parents are some of our hardest workers and some of our greatest heroes. I have met some of them. Boy, do they struggle. And we should have been trying to help them, not make their lives more difficult. New provisions, credit card counseling requirement, increased fees, complicated paperwork, have steered many deserving people away from filing, and even though who cannot afford to pay for credit counseling are required to undergo financial literacy training before they can file a petition to erase their debt.

By some accounts, at least, this is an ineffective bureaucratic hurdle. The survey results from credit counseling firms have shown that fewer than 1 out of 20 consumers were actually candidates for paying off their debt under a debt management plan; 96.7 percent still needed to file for bankruptcy as they would have even prior to the passage of this bill.

So the bottom line here is that in an attempt to rewrite the fraud and abuse out of our bankruptcy laws, we may have written in some complications and confusion. It may well be—and this is something I guess we will continue to examine—that this Act was too blunt an instrument, however noble its goals.

The one-size-fits-all approach doesn't take into account the majority of people whose only crime is a catastrophic illness, the death of a loved one, or some other similar tragedy. It imposes fee increases on people who cannot afford them, mandates counseling requirements that may be ineffective and counterproductive.

So let me say, in conclusion, this is a complicated and important issue. There are many points of view. I am glad we have such a distinguished panel of experts, judges, trustees, and professors to help us sort out some of the complexities. And, again, Mr. Chairman, I thank you for holding this hearing.

Chairman SESSIONS. Thank you, Senator Schumer.

Senator Grassley, do you want to make some opening comments?

Senator GRASSLEY. I think I will just put it in the record because I have to go.

Chairman SESSIONS. You have to go this very minute.

Senator GRASSLEY. I think so. My staff is out there.

Chairman SESSIONS. I thought they worked for you, not you working for them.

[Laughter.]

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. I just got the signal that I have got a little bit of time, and I am going to take advantage of it.

Chairman SESSIONS. You are absolutely entitled to it. You have worked this issue for many years, and I know you are proud to see it come to fruition.

Senator GRASSLEY. Everything that has been said on this subject has probably been said, but I haven't said it, and, by golly, I am going to say it.

[Laughter.]

Senator GRASSLEY. First of all, congratulations to you, Mr. Chairman, for your help in getting this bill passed in the first place, and I thank you for these continued efforts, as demonstrated by this hearing, to make sure that our new bankruptcy system law works.

As you well know, this law was a result of more than a decade of comprehensive study and intense debate in Congress, and whatever criticism one may do about this legislation, I think there are some essentials that you have to remember about it. It was spread out over so many Congresses, the debate, that it was surely well vetted, and there was a lot of compromise on both sides. And in the end, the large bipartisan majorities, Republicans and Democrats voting together, to enact it showed a very serious need for the reform and that this reform was the way to do it; otherwise, you do not get those kinds of votes of 75–25 and one time 97–2.

Why so much support for bankruptcy? Well, the majority of Americans knew that the bankruptcy system was broken and needed to be improved. The central premise of bankruptcy reform is that if an individual who wants to file for bankruptcy can repay some of his debt, then he ought to pay some of his debt and not get off scot free. As I have said many times before, we needed to restore balance to the bankruptcy process, that it had become too easy where clever lawyers gamed the integrity of the bankruptcy system for the benefit of individuals who wanted to get out of their debts entirely and to the detriment of people who played by the rules. That is why bankruptcy rates of the 1990s soared, and despite the fact that the economy was so strong during that period of time.

With the new bankruptcy laws, Congress closed some of these loopholes and enacted some important consumer protections. The new bankruptcy law created a means test. The law injected more integrity and fairness into the bankruptcy system.

So how has the new bankruptcy law worked? Well, that is the purpose of this hearing. But early reports indicate that it is working very well by the number of bankruptcies that have gone down that the Chairman has already referred to, and I am not going to repeat those numbers.

So in my mind, fewer bankruptcy filings are bound to boost the American economy. When considering the effects of bankruptcy on the economy, I often recall Clinton administration Treasury Secretary Larry Summers saying that the high levels of bankruptcy tended to push up interest rates. So lowering bankruptcy rates would reduce upward pressure on our economy based merely on these decreased filing rates. I think it is fair to say that bankruptcy reform has been a success for our economy.

Earlier this year, I stated on the Senate floor that the numbers indicated that bankruptcy reform has saved our economy $60 billion. That is a substantial savings. That is around $60 billion that would have been lost, that would have been a drag on our economy, and I am confident that at least some of that money has been or will be directed toward economic growth and the creating of American jobs.

It is also important to remember that there were a number of consumer protections included in the new bankruptcy law. People considering filing for bankruptcy have access to no-cost or low-cost credit counseling and financial education. We want people who make bad financial choices to learn how to deal with their finances and not get caught up in a bankruptcy recycling. After all, better educated consumers are a benefit to everyone. The law even encourages education of young people how to handle their finances, and credit card companies are required by the new law to warn consumers about the dangers of making only minimum payments.

But there are challenges. The power special interest groups here in Washington that opposed bankruptcy reform in the first place have not gone away. They are still trying to undermine the common-sense reforms by filing lawsuits challenging these reforms and by supporting regulations to water down the law.

The Federal courts produced a bankruptcy form that is supposed to measure repayment ability, but it is my understanding that this form actually directs consumers to claim deductions for expenses a debtor may not even have. That certainly was not the intent of the law. The form legitimizes gaming of the law, reduces the integrity of the system, and ultimately undermines reforms.

Moreover, everyone who has followed this issue for any length of time will recall how the Federal Trade Commission had to issue a public warning over sleazy business practices in the bankruptcy mills. Congress responded to this by enacting some dramatic consumer protections. But how has the bankruptcy bar responded? You would think by cleaning up their act and by increasing professionalism. Unfortunately, that does not seem to be the case. The bar has responded to our attempts to help consumer by seeking to declare these consumer protections unconstitutional. In fact, right now in a Connecticut court, consumer bankruptcy lawyers are trying to convince a Federal judge that they have a right to advise people to commit fraud by telling consumers to run up debt that they have no intention of ever repaying. Right now these lawyers are trying to get out of disclosing to their clients what their fees are.

No wonder even the American Bar Association has acknowledged that there is a real need for special disciplinary rules of consumer bankruptcy lawyers, and there is growing evidence that consumer bankruptcy lawyers are trying to deny consumers access to valuable credit counseling by trying to buy off the counselors.

Just recently I joined Chairman Sessions in a letter to the Justice Department asking about one counseling agency that actually solicited business by promising not to advise consumers about alternatives to bankruptcy. The Department of Justice has done an admirable job in defending the law, but they shouldn't have to use precious time and resources defending needed consumer protections. They should be free to use their resources to protect the consumers directly.

I have seen even more than one instance of bankruptcy judges criticizing the new law in very inappropriate ways, and that is extremely disappointing. Of course, any judge should be free to exercise his or her judgment about how to interpret a law, and I certainly would never infringe on that core work. But when judges give press interviews and call the new law "garbage" or question Congress' motives for passing bankruptcy reform during a court hearing, I think that clear line has been passed. Congress writes the laws. Judges are supposed to interpret and apply the law impartially.

The bottom line is Congress passed bankruptcy reform by a wide margin with both Republicans and Democrats supporting it. That is how the American legal system is supposed to work. We have a democracy. Unelected Federal judges do not get to substitute their own personal policy preferences for the considered judgment of the elected branches. But that does not appear to matter to some bankruptcy judges who have decided they know better than everyone else how this country ought to be run.

That is why I intend to write a letter to Chief Justice Roberts asking him whether this conduct violates ethical rules for judges. Judges are supposed to be neutral. They are supposed to understand their role in our legal system. I hope that Chairman Sessions will join me in looking into this matter and will sign onto that letter to the Chief Justice.

All in all, Mr. Chairman, I think the new law is working well. We need to be vigilant here in Congress as the law is implemented and to make sure that people who do not want to follow the law's mandates and good reforms are not undermining the law and the integrity of the bankruptcy system or shirking their responsibilities to enforce the law.

So this hearing and others I am sure you will have will help up keep a watchful eye on the developments in the evolvement of this legislation in the future.

Senator SCHUMER. Mr. Chairman?

Chairman SESSIONS. Yes, sir?

Senator SCHUMER. Could I just ask unanimous consent to put the American Bar Association's entire statement in the record?

Chairman SESSIONS. We would be pleased to make that a part of the record.

Our first witness on this first panel is Mr. Cliff White. He serves as the Director of the Executive Office for U.S. Trustees here in Washington, D.C. He has served in the Federal Government for 26 years, including previously as Assistant United States Trustee and Deputy Assistant Attorney General within the Department of Justice and as Assistant General Counsel at the U.S. Office of Personnel Management. He is an honors graduate of George Washington University and the George Washington University Law School. He has been recognized with a Presidential Rank Award for Meritorious Executive Service in 2006 and with the Attorney General's Award for Distinguished Service in 2003.

They do not give many of those, do they, Mr. White?

Mr. WHITE. In my case, maybe too many.

[Laughter.]

Chairman SESSIONS. No, that is a rare award. I got one one time. I cherish it.

Also, we expected to have on the panel Judge Thomas Zilly of the U.S. District Court for the Western District of Washington, who currently serves as Chairman of the Judicial Conference Advisory Committee on Bankruptcy Rules. He submitted an excellent statement, and we will make that a part of the record. And I think it is fair to say that he is supportive of the Act.

Mr. White, we would be delighted to hear from you at this time.

STATEMENT OF CLIFFORD J. WHITE III, DIRECTOR, EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES, DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Mr. WHITE. Thank you and good afternoon, Mr. Chairman. I thank you for the opportunity to appear before you today to discuss the progress made by the U.S. Trustee Program to enforce and implement the new bankruptcy reform law. I am pleased to report to the Subcommittee that the program has made major progress in achieving its goal of making bankruptcy reform work for all stakeholders in the system—debtors, creditors, and the general public. And although, as the members said in their opening statements, it is still far too early to determine the long-term impact of the reform law, the reforms have been workable, and there are promising signs for positive results in the future.

Chairman SESSIONS. Mr. White, before you go much further, would you just basically tell those who do not understand the role of the U.S. Trustee what kind of role you play in the bankruptcy court system?

Mr. WHITE. We are called, in the words of the legislative history, the "watchdogs" of the system. Our basic mission is to enhance the efficiency and the integrity of the system. So, for example, we appoint the private trustees who administer 95-plus percent of the bankruptcy cases. We also litigate in bankruptcy court, enforcing the bankruptcy law on such matters as debtor wrongdoing or attorney wrongdoing, and bring matters to the court. So we have administrative responsibilities in overseeing the trustees, litigation enforcement responsibilities against debtors or others in the system going before the court. And we have jurisdiction in all districts of the United States except those judicial districts in Alabama and in North Carolina.

Chairman SESSIONS. Those are the trustees remaining under the court system, but overwhelmingly they are part of the Department of Justice, and you are involved in all the cases that come through the bankruptcy courts in the country?

Mr. WHITE. That is correct.

Chairman SESSIONS. So you have a unique perspective, and I just wanted to get that point in. Go ahead, please.

Mr. WHITE. Thank you very much for that.

One of the reasons, I suggest, Mr. Chairman, that we have been able to meet the challenges presented by the reform law is that we are building on 5 years of progress realized through our civil and criminal enforcement initiatives. These enforcement efforts reflected a balanced approach to address both the debtor wrongdoing as well as to protect consumer debtors who were victimized by attorneys, petition preparers, or others.

In the last fiscal year, fiscal year 2006, we estimate that we took more than 58,000 civil enforcement and related actions with a monetary impact in the system of more than $878 million in debts not discharged, fines, penalties, and other relief. And since we began tracking our results in 2003, we have taken more than 220,000 actions with a monetary impact in excess of $2.6 billion. We also—

Chairman SESSIONS. Could you explain what an enforcement action is, typically?

Mr. WHITE. Certainly. They come in a variety of modes, but the most common ones, for example, would be if a debtor had an ability to repay. Even before the statute, there was some ability that we would have to bring an action. We have more tools through the new statute to bring these actions. But if a debtor was abusing the system because the debtor had run up debts and had the ability to repay those debts but still sought Chapter 7 relief, we could file a motion to dismiss that case in bankruptcy court. So the debtor would either have to repay part of those debts in Chapter 13 or have the case dismissed, in which case the debts would not be discharged at all.

In a consumer protection context, which has also been an important part of our civil enforcement efforts, if a debtor was victimized by, say, a non-attorney petition preparer, someone who claimed to be a credit doctor could fix the credit woes and might, for example, file a bankruptcy petition, sometimes even without knowledge of the debtor, we would have jurisdiction to go to the bankruptcy court to seek relief against the party who had victimized the debtor.

So we have taken those kinds of actions, as well as more serious ones. So, for example, if the debtor has actually lied, concealed assets in the bankruptcy papers filed under penalty of perjury in bankruptcy court, we can take action which will cause not just a dismissal of the case but a denial of discharge of those debts.

So those are three of the more common examples of the kind of cases that we have brought in the past and which the Congress has given us now new tools to be able to continue to do in the past year since the general effective date of the new law.

If I may go on, Mr. Chairman, as well, we have also enhanced our criminal enforcement efforts. We have a responsibility under the statute to make referrals to United States Attorneys where we have evidence that a bankruptcy crime has been committed. And some of our results in this regard were illustrated as recently as just a few weeks ago when the Deputy Attorney General, Paul McNulty, announced the conclusion of what we called "Operation Truth of Consequences," which was a nationwide bankruptcy fraud sweep, in which United States Attorneys filed criminal charges against 78 defendants in 36 judicial districts.

Now, under the reform law, or BAPCPA in the shorthand, the program has taken on, as the Chairman well knows, substantial new responsibilities in several key areas which are covered in my written statement, and if I may, I would like to highlight just three of the consumer provisions and some of our activities in those areas.

The first is means testing. Under the new Section 707(b), the former subjective "substantial abuse" standard has been replaced by a more transparent and a more objective means test formula to determine whether a case is, in the terms of the statute, "presumed abusive."

While it is still too early to determine the long-term impact of means testing, I would like to suggest to the Subcommittee two preliminary conclusions. The first is that means testing is a workable system. There is now a system in place by which debtors can obtain the necessary IRS and Census Bureau information that is needed to complete the means test and to make the required calculations. And there is now a system in place for the U.S. Trustee staff to process that information, to make a determination of "presumed abuse," and then decide in those cases of presumed abuse whether the facts warrant bringing a motion to dismiss.

My second preliminary conclusion on means testing is that the early data suggests that means testing provides a promising approach to identifying abuse. Of the individuals debtors with above median income—those who are subject to the full means test—the U.S. Trustee has determined—and this was reflected, I know, in the Chairman's opening statement. We have determined that slightly less than 10 percent of those debtors are presumed abusive. And of the presumed abuse cases that did not voluntarily dismiss or convert, the U.S. Trustee filed motions to dismiss in about three-quarters of those cases, meaning we declined to file in about one-quarter of the cases. So to us, these data would suggest that the means test has been a useful screening device to identify abusive cases, and it also suggests that the statute has indeed provided the U.S. Trustees with sufficient discretion so that decisions on filing motions can be made on a case-by-case basis and not solely upon a statutory formula. We can take into account special circumstances under the statute.

Another major aspect of bankruptcy reform is financial education. Individual debtors must receive credit counseling prior to filing bankruptcy and receive debtor education prior to receiving a discharge. These are potentially among the more far-reaching consumer protection provisions of the new code because these requirements are designed to ensure that debtors enter bankruptcy knowing what their options are and they will exit bankruptcy with more tools to avoid future financial catastrophe.

Among the jobs of the U.S. Trustee in this regard is to approve qualified providers to provide those services if they meet certain statutory qualifications.

I would suggest that, as with means testing, there are positive signs that the credit counseling and debtor education provisions are workable. The credit counseling industry has been a troubled industry, so our first priority in the U.S. Trustee Program was to put into place a system so that we could try to screen out those agencies that might seek to defraud debtors. And we developed our approval and our monitoring criteria within enormous assistance from the FTC and the IRS. And just this past September, we further strengthened our efforts by commencing a new post-approval, onsite review process to better verify an applicant's qualifications.

Through the end of last August, we had received about 700 initial applications from providers. About two-thirds were approved, but about one-third were either denied or voluntarily withdrawn after we asked additional questions and withheld approval.

In addition, to date there is adequate capacity to serve the debtor population. There are currently 155 approved credit counseling agencies nationwide and 285 approved debtor education providers. Let me add as well that we did exempt debtors from the credit counseling and debtor education requirements in those judicial districts that were most heavily affected by Hurricane Katrina. And as the number of bankruptcy filings nationwide increases, we are going to continue to monitor that 155/285 number to ensure that there is adequate capacity.

Finally, the third and final aspect I would like to highlight are debtor audits because, as the Chairman noted in his statement, a new regimen for debtor audits commenced with cases filed on October 20 of 2006. We believe that these audits will help us to identify cases of fraud and abuse, to enhance deterrence, and also to help us better measure the magnitude of fraud, abuse, and errors in the system. So in the current fiscal year, in 2007, we will use contractors to conduct up to 7,000 audits of cases filed by individual debtors.

So the bankruptcy reform law has presented many challenges to the U.S. Trustee Program, but we believe that the diligence and professionalism of the program staff at all levels have allowed us to make some substantial progress, and we look forward to making continued progress in the coming year. I would be happy to answer any questions from you, Mr. Chairman, or other members of the Subcommittee.

[The prepared statement of Mr. White appears as a submission for the record.]

Chairman SESSIONS. Thank you very much, Mr. White. Those are impressive remarks, and I can tell that you have taken this seriously and you have the capability of being an effective leader of the trustees.

We have seen a substantial decline in filing rates, 40 percent perhaps. What is your view of why that has occurred?

Mr. WHITE. Well, I do not think that I have a definitive answer, so let me suggest several factors that I think there is perhaps even consensus in the bankruptcy community, or at least factors that are commonly cited by commentators of differing points of view in bankruptcy reform.

One is the surge in filings that occurred just prior to the general effective date of the statute. There were 600,000 cases filed in the 2 weeks prior to the October 17 general effective date. Three-quarters of a million cases were filed in the 1 month prior to the general effective date. So with that number of filings, it is not at all surprising you would have a smaller number thereafter.

Also, the nature of the new bankruptcy reform law or the means testing provision is to make the system more transparent, more objective, meaning there can be more self-policing, if you will. Debtors and their counsel should know when they file the petition if it is going to trigger a finding of presumed abuse. So that may lead debtors to file 13 or not to file at all. We cannot measure the direct impact of that, but that is certainly a plausible reason.

A third that I have heard many debtors' counsel talk about themselves is the learning curve that was involved for debtors' counsel getting used to a new system.

Another factor I would point to is misinformation. There was a great deal of misinformation prior to the effective date and afterwards with regard to the Act, suggesting honest and needy debtors no longer had that relief available. And that may have had a deleterious effect on debtors who were entitled to the relief but have not sought it because the strident rhetoric suggested it was not available to them anymore.

Others have also referred to additional costs to the system. Debtors' attorneys fees have gone up. Some of that could be due to, among other factors, again, the learning curve of debtors' counsel, retooling their systems, and maybe some of those costs can come down as they realize new economies of scale and get further along the learning curve.

So those are five factors commonly cited. I cannot point to empirical evidence that says any one or a combination of those, but those are some plausible explanations that are commonly heard.

Chairman SESSIONS. Thank you. I do not think, do you, that a mere decline in number of cases a bankruptcy office may be filing would justify increasing fees, do you?

Mr. WHITE. No. Well—

Chairman SESSIONS. I have a little suspicion, frankly, that some lawyers are raising their fees simply to maintain their current level of income even though filings may be down. Do you have a similar suspicion?

Mr. WHITE. I really don't know the reasons. We often do ask debtors' counsel. Their fees must be reasonable. Courts can correct excessive fees. And I think that it is a dialog we try to have with debtors' counsel as to if fees are raised, why are the fees raised, because I do think that it is an important factor that needs to be scrutinized. But I just cannot come before you and say I have a strong suspicion or knowledge as to what any single cause of that is.

Chairman SESSIONS. I can understand that. Somebody said recently, "I don't know much, but I have a lot of suspicions."

[Laughter.]

Chairman SESSIONS. So perhaps we should not even raise suspicions.

On the means test effectiveness, you said it is workable. Some thought it might not be, but I always thought it had enough clarity that the system would work pretty well and the largest number of people would be unaffected by the change. Since they would be making below median income, it would have virtually no impact on them. But if they make above the median income, they can be presumed to be an abuser.

When this happens, the Department of Justice can move to dismiss the case or decline to do so. Do you know the number you filed on, the number of objections you filed to Chapter 7?

Mr. WHITE. Since October 17 of the 707(b), which is mainly the means test, not exclusively, the number is relatively modest because the number of filings is so low. About 1,300 cases were actually filed. But that is after we exercised discretion, and one out of every four presumed abuse cases we found had special circumstances.

Chairman SESSIONS. But that would indicate, would it not, that 99 or whatever percent is filed are filing correctly, and the projections that there would be disaster from this would be overblown. Is that correct? Would you say that?

Mr. WHITE. I would say that the means test has been an effective screening device and that we have tried to exercise discretion and believe that the statute has given us discretion so that we are not filing motions in cases that are not meritorious.

Chairman SESSIONS. Is it true that less than 1 in 100 filers have been challenged by these motions?

Mr. WHITE. I believe that is the way the ratios finally work out, yes.

Chairman SESSIONS. I am informed that no creditors have filed 707(b) motions, but that only the trustees have done so. Is that correct?

Mr. WHITE. I do not have any specific data, but that is my understanding. But I do not have the data that would prove that. We do not collect it on the creditor motion.

Chairman SESSIONS. Senator Grassley had some harsh words about the deductions for expenses form, deductions that debtors do not actually have. The Judicial Conference, I understand, developed a standardized form for implementing the means test. Is there any part of these forms, particularly Form 22, which calculates the means tests, which in your judgment permits debtors to claim a deduction for expenses they do not actually have?

Mr. WHITE. Let me first say we have been a part of the Advisory Committee on Bankruptcy Rules, which is chaired by District Judge Zilly, and I believe that Judge Zilly has done a tremendous job in guiding that committee. There have been scores of new rules and forms that have been issued, and what the Committee is doing now—it put out the interim rules for public comment. It is reviewing comments and will at the March meeting review again the rules and forms to see if additional modifications are necessary.

Now, we are litigating one issue related to what you said, Mr. Chairman—and it is not a product of the form—having to do with whether or not an ownership expense for an automobile may be claimed by all debtors even if they do not own an automobile. The IRS says if you own an automobile, you get a certain amount that is allowed, and the statute allows you also, if you have a higher secured debt. But if you do not own an automobile, we argue and have argued in court, not always successfully, that you do not get that deduction for owning an automobile. So some issues like that do arise. And there may be some issues that some have raised with regard to the means testing form, but I would have to say that we believe that the Rules Committee has acted very responsibly and in good faith.

Chairman SESSIONS. Thank you for those insights. You do feel that you represent and have a responsibility to advocate for integrity and forms that actually work to ensure the integrity of the process. So you see your role—you do not have any hesitation to advocate improvements in the form if you think there are difficulties, do you?

Mr. WHITE. Not at all.

Chairman SESSIONS. You understand that is your role and you will do so.

Mr. WHITE. It is a fundamental duty of ours, Mr. Chairman.

Chairman SESSIONS. I think the question arose from, I guess, line 22 in the form, and I would ask you to look at that.

Mr. WHITE. Certainly.

Chairman SESSIONS. It says you are entitled to an expense allowance in this category regardless of whether you pay the expenses of operating a vehicle or regardless of whether you use public transportation. That is the issue you just raised. It strikes me that it is almost like saying if you own a home, you can deduct the interest, but if you do not own a home, you can deduct the interest anyway. So I do not think that is good legal policy the way that is suggested there.

In both 2006 and 2007, the Senate Committee on Appropriations included language in their reports supporting use of data-enabled forms. In your presentation to the ABI last month, you argued for the same. You said, "My concern about our long-term ability to efficiently process the forms rises largely out of the fact that courts have not yet mandated smart forms with data tags that could allow us to automate most of our procedures. We are hopeful that the Judicial Conference will adopt mandatory technical standards for petitions and schedules."

Can you explain for the non-computer-savvy listener what a smart form data tag is?

Mr. WHITE. I will try as a non-computer-savvy person myself. The data tags are really a software that embeds codes into forms that are filed electronically with the court. Bankruptcy forms largely are filed electronically. And what that allows is for data from those forms to be aggregated in an automated way, less person-intensive, to do such things as in means testing, a vital concern to us, to be able to segregate cases that are above median income, that require the full means test, versus below.

If we are able to aggregate data through these smart forms, if everyone files or most filers file with smart forms embedded per the court's mandate, then we would be able to better achieve the Congress' objective as well with regard to non-random debtor audits where we have to make determinations of whether or not debtors in cases have unusually high expenses in a particular judicial district so to best carry out those non-random audits, according to the Congressional criteria.

The GAO has a need for them. Recently, for example, we met with the GAO as it commenced a study of domestic support order treatment under the new Bankruptcy Code. And one of the issues that we discussed was how to identify the cases, and they have to do it more through a random, manually intensive way. If there were these invisible data tags in the forms, it would be much easier for GAO to identify those cases, and it would have great benefit for scholars, too.

We have been working with the courts on that for 19 months. I am very hopeful that something will be done very soon, particularly as filings go up, because I think it is going to allow us to administer the system more efficiently and will have great benefits for policymakers and scholars.

Chairman SESSIONS. Thank you.

What is your assessment of the credit counseling provisions? And how is that working? That is an entirely new concept, and I would be interested in your opinion.

Mr. WHITE. Well, as with other aspects of bankruptcy reform, no definitive conclusions do we believe we can draw at this point, but we think there are, again, some positive signs, and let me suggest three from the perspective of the U.S. Trustee.

One of the first challenges, as I noted in the testimony, was to put together a screening system—it was a troubled industry—to ensure that the applicants, the agencies that are allowed to provide these services to debtors met statutory qualifications, were legitimate agencies and not seeking to defraud debtors. And we believe that with the help of other agencies we have had an effective screening process. We have rejected about one- third of the applicants that have come before us.

Chairman SESSIONS. These are one-third of the credit counseling agencies.

Mr. WHITE. Credit counseling and debtor education put together.

Chairman SESSIONS. They want to be approved for the bankruptcy court. You have turned them down for reasons—

Mr. WHITE. That they did not meet the qualifications, and some of the common reasons, for example, if they are under an IRS audit; if they failed to provide us with the information that they gave to the IRS, which the IRS for good reason statutorily could not provide us; if the board of directors was not independent; among other reasons, if we found that there was a tie-in on credit counseling—or the credit counseling agencies which must be not-for-profit, if, in fact, they had a tie-in with a for-profit agency, so we looked very much for integrity issues. And we scrutinized these applications quite carefully. We think we will get better at it as we get more experience. But we do think we have a very useful device, and it did screen out one-third.

Second, we were concerned and there remains a concern about capacity, because you have a new market, a lot of potential new debtors in the system. The number of filings has been low, so it is easier for there to be capacity. Capacity is there. We are going to have to continue to watch that somewhat carefully.

We were pleased that, despite certain issues raised by credit counselors in terms of cost and their long-term financial wherewithal, all of the major agencies that were approved for their initial 6-month period also reapplied for another year. But we are going to continue to watch that.

And the third—

Chairman SESSIONS. All that were approved reapplied?

Mr. WHITE. All of the major agencies. There were very few that had originally applied and been approved who did not reapply.

Chairman SESSIONS. So their experience was such that they did not feel they needed to drop out of the program. They must have felt like it had some workability for them.

Mr. WHITE. That is correct. But we certainly are sympathetic to concerns they have, and we will continue to work with them to see if there is any way in a regulatory way—if there is any way we can relieve burdens on them but still preserve the integrity of the system, we want to be sure that we do that.

A third element you referred to, Mr. Chairman, I believe, in your statement—although we need time series data, we need more of a period of time to reach a conclusion—is that we do track the number of certificates that are issued. A debtor who goes in for credit counseling must produce a certificate with the petition. Ten percent more certificates were issued by agencies than bankruptcy filings. Some of that could be just a delay before there is a filing, or it could show that, in fact, the counseling has led some debtors to see that they had a better alternative than filing of bankruptcy.

So those are three positive signs. We need to continue to look at all of those things. They are preliminary and no firm conclusions, but they do provide some encouraging data.

Chairman SESSIONS. That was my thought from the beginning, that some people—and I have often said, I predicted a 10 percent or so—I would say if 10 or 15 percent who go to credit counseling might find they have an alternative to bankruptcy, they might choose that. I know a friend who went to extraordinary lengths to not file bankruptcy and really worked exceedingly hard. He just did not want to do that. And credit counseling sometimes can help people to avoid it and give them additional options.

We did see and heard some concern about counseling agencies that advertise as being in virtual partnership with the lawyers who might be referring their clients to the credit counseling, virtually promising to not dissuade them or suggest anything other than their filing bankruptcy. Have you seen that information? And does it trouble you?

Mr. WHITE. Yes, to both questions. It is critical for the integrity of the process for the counseling to be direct and for it to be unbiased. So anything that interferes with the direct, unbiased nature of that counseling would undermine the integrity of the system.

There was one instance that comes to mind that arose in October, and a website by an agency was changed because it contained some language that suggested the lack of that objectivity. Obviously, as you can understand, I cannot comment with regard to any additional investigation that may be ongoing.

We also issued interim rules on credit counseling, and we are going to be revisiting them. We are looking at comments we got on those rules and are looking at a fuller rulemaking process later in the year. And one of the areas that has been raised to us as perhaps we can have more complete regulation is in looking—

Chairman SESSIONS. You do not need statutory authority to change that regulation, do you?

Mr. WHITE. No. But I would say one of the things we do need to look at, Mr. Chairman, is what are the limits, though, for certain areas that people suggest we ought to regulate is whether the statute lets us regulate, without reaching a legal conclusion going to the issue of receipt of payment of the debtor's lawyer paying the credit counseling fee. Section 110 of the code regulating bankruptcy petition preparers, not credit counseling, for example, says that it is prohibited for a petition preparer to pay a court filing fee. Section 111 does not have exactly the same language. So we obviously need to parse the statute. We have regulatory authority. We are going to look at it. But we are obviously going to be very careful that we stay within the bounds of what we are authorized to do.

Chairman SESSIONS. In the letter that Senator Grassley and I wrote to you, we noted that, for example, the Hummingbird Agency website advertises they directly contract with attorneys, not debtors, that they accept fees from attorneys, and promise that attorneys will not "lose customers." So that really goes to the very heart of what I think the provisions intended, and I hope that you will keep an eye on that.

Mr. WHITE. Yes, sir.

Chairman SESSIONS. On the next panel, we will hear from David Jones, President of the Independent Consumer Credit Counseling Agencies. He wants the U.S. Trustees Office—that is you—to issue guidance for credit counseling agencies in three areas: ability to pay, definition of "legal advice," and obligation to negotiate a repayment plan with the debtor's creditors.

Is the Trustees Office planning on issuing guidance to credit counseling agencies in these areas?

Mr. WHITE. Well, we are looking at that. We have seen the comments from Mr. Jones and others that came in with respect to our interim rule. We are looking at those as we fashion a new Notice of Proposed Rulemaking.

Chairman SESSIONS. I think those are legitimate requests, and I hope that you can work toward that.

Anything else you would like to offer to the Committee as we evaluate this first year of the bankruptcy law?

Mr. WHITE. No, Mr. Chairman, except that we do think that the new law has given us new tools to enhance the integrity and the efficiency of the system. We have a lot still to learn, and we will continue to try to make more progress in the next year. But we do think there are some promising signs from the first year of enforcement and implementation.

Chairman SESSIONS. Well, I share Senator Grassley's view that bankruptcy is a great American tradition, that people who are in debt that they cannot repay are entitled to seek the protections of bankruptcy, but it is not a guaranteed right to abuse the system. There has been widespread concern throughout the country that bankruptcy had been completely out of control, that people were filing bankruptcy when they had other alternatives, that nobody was watching the store or monitoring the fraud and abuse. And I do believe this system, the new system, can help restore confidence in the system without in any way denying people who legitimately have bankruptcy rights those rights. I really feel strongly about that, and I appreciate your work on it.

I also would like to express my appreciation to Mr. McNulty and his prosecutions of criminal activities. You mentioned 70, I believe—50-some-odd defendants were charged recently. I would note as a lawyer with some sadness, nine of those were attorneys. And so that indicates to me that officers of the court in a number larger than we would like to admit may not be adhering to the high standards of professionalism. I hope that these better forms, the clarity of that, the increased ability for the trustee to have oversight over the problems can help end that.

I thank you for your leadership.

Mr. WHITE. Thank you, Mr. Chairman.

Chairman SESSIONS. Thank you.

[The prepared statement of Mr. White follows:]

Chairman SESSIONS. Our second panel, if you would step forward. I think you perhaps know our first witness is Todd Zywicki, law professor and senior fellow of the James Buchanan Center, Program on Politics, Philosophy, and Economics at George Mason University. He teaches in the area of bankruptcy, contracts, commercial law, business associations, law and economics, and public choice and the law. That is quite a lot. He has testified several times before Congress on the issues of consumer bankruptcy law and consumer credit, including testifying before this Committee last year before the passage of the bankruptcy bill. Prior to this, he served as a Director of the Office of Policy Planning at the Federal Trade Commission, was recently named a member of the United States Department of Justice Study Group on Identifying Fraud, Abuse and Errors in the U.S. Bankruptcy System, and I am proud DOJ is working on that. He received his J.D. from the University of Virginia, his M.A. in Economics from Clemson University, and an A.B. cum laude from Dartmouth College.

Our second witness is Mr. Steve Bartlett, President and CEO of Financial Services Roundtable. He previously served as mayor of Dallas, Texas. That was a headache, I suspect.

Mr. BARTLETT. It was one of the more enjoyable and exhilarating experiences in my life.

Chairman SESSIONS. Big D. That would be a great challenge, I am sure. A Member of the United States Congress—that would be easy compared to being mayor, I suppose—and while in Congress, he served on the House Banking Committee and was a leader in financial modernization. You served as Deputy Whip and was a sponsor or principal cosponsor of 18 major pieces of legislation, including the Enhanced Secondary Mortgage Market Pact, FHA regulation, Fair Labor Standard Act reform, and the Disabilities Act. You have your B.A. from the University of Texas, Austin, and adjunct professor and lecturer at the LBJ School of Public Affairs. And Dr. Gates, who is on the floor now, is still celebrating the Texas A&M game. My condolences.

Our third witness is David Jones, President of the Association of Independent Consumer Credit Counseling Agencies, from Florida. He served as President for the last 6 years. In 2003, he retired after 6 years as President of a major national credit counseling and consumer education agency. You presently concentrate efforts in support of the credit counseling industry.

Our fourth witness is Hon. Randall Newsome, Chief Judge of the Bankruptcy Court for the Northern District of California. He has been a bankruptcy judge since 1982, beginning in Cincinnati, before appointment in California. Judge Newsome has served as President of the National Conference of Bankruptcy Judges from 1998 to 1999 and is a fellow of the American College of Bankruptcy and a member of the American Law Institute. He currently serves as a faculty member for the Federal Judicial Center, ALI, ABA, and other organizations. He has testified before committees of Congress on bankruptcy reform legislation and is a contributor to "Collier on Bankruptcy" and other writings.

Our fifth witness is Robert Lawless, a professor at the University of Illinois College of Law, where he teaches bankruptcy, consumer law, and corporate reorganizations. He has been a law professor at the University of Nevada, University of Missouri, Columbia, Washington University, and Ohio State. Professor Lawless has served as a panelists and presenter at five different bankruptcy and consumer credit symposia and conferences in the last 6 years. He graduated with his J.D. and a bachelor of science in accountancy with highest honors from the University of Illinois.

Our final witness is Henry Hildebrand, Chapter 13 Standing Trustee from the Middle District of Tennessee. He administered nearly 14,000 active Chapter 13 cases and distributes more than $150 million per year to creditors. He is a counsel to the national law firm of Lassiter, Tidwell & Hildebrand. He is a fellow of the American College of Bankruptcy and on its Education Committee, a board-certified consumer bankruptcy lawyer by the American Board of Certification, and serves on its board of directors. Mr. Hildebrand served as notes editor for the Quarterly, a newsletter dealing with consumer bankruptcy issues and Chapter 13 practice, and is a regular contributor to the American Bankruptcy Institute Journal, a graduate of Vanderbilt University, received his J.D. from the National Law Center of George Washington University.

That is a distinguished panel indeed, and without further ado, perhaps, Mr. Zywicki, if you have any thoughts, we would hear from you at this time. We will have a 5-minute limit, and if you feel like you need to exceed that, remember you can place those remarks in the record.

STATEMENT OF TODD J. ZYWICKI, PROFESSOR, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ARLINGTON, VIRGINIA

Mr. ZYWICKI. Thank you, Mr. Chairman. It is a pleasure to be here today. As you noted, the Bankruptcy Abuse Prevention and Consumer Protection Act was enacted last year after 8 years of study, deliberation, and hearings by this body and Congress and passed with bipartisan support. I understand the purpose of today's hearing is to understand and evaluate how the Act is operating in practice.

As has been previously emphasized, everything that we say today is going to be tentative, but based on my observations so far, the Act seems to be working largely as Congress intended. And so, as a result, so far it appears to be successful.

As I understand, the purpose of BAPCPA was to preserve bankruptcy relief for those who need it and reduce fraud and abuse by those who do not. The Act seems to be operating well on both of those accounts.

First, the first question is whether or not it preserved bankruptcy relief for those who need it. Critics argued before the Act was passed that it would result in widespread hardship and distress among those who needed to file bankruptcy because of job loss, illness, or the like and would be unable to do so; that it might harm those who were victims of natural disasters, such as hurricanes; and, third, that it would somehow harm women's efforts to collect alimony and child support in some poorly specified manner from deadbeat parents.

So far, each of these concerns seems to have been unfounded. First, there seems to be no evidence of serious lack of access to the bankruptcy courts. I have heard no reports of those who needed bankruptcy relief and have been unable to get it. The best evidence that we may have on whether this is happening is if we expected that people were unable to get bankruptcy relief, you would expect to see non-bankruptcy delinquencies and charge-offs to be rising, and that does not seem to be the case. The numbers seem to be basically equivalent to 2004, which suggests that there are not people out there who are struggling to pay their bills who need to file bankruptcy and are unable to do so.

Second, with respect to victims of natural disasters, most notably Hurricane Katrina, as Cliff White noted on the last panel, it appears that the system certainly has enough flexibility and discretion to deal with those sorts of situations, and we have not noticed any problems with that.

Third was the question about the notion that somehow this would make it more difficult for women to collect alimony and child support. That was never a very plausible argument in the first place. The legislation quite plainly enacts a number of new protections and powers for women. It was repeatedly testified at the time by experts in this area that the biggest obstacle to collecting alimony and child support was often bankruptcy filings, efforts by parents, deadbeat fathers to manipulate the system in order to discharge some obligations, to use the automatic stay to prevent collection, that sort of thing. There seems to be no evidence of this purported harm to women, and on this it seems to have unequivocally increased the ability of women to collect in bankruptcy, just as had been predicted.

The second goal then was to reduce fraud and abuse in the system. As has been noted, filings have dropped dramatically. There seems to be no question based on the experience of last fall of what many thought, which is that to some extent people's willingness to file bankruptcy is related to the incentives provided by the bankruptcy laws. The fact that 500,000 people managed to find their way to the bankruptcy court in the 2 weeks prior to the bankruptcy law going into effect shows that people do have some discretion over when and whether they file bankruptcy.

There has been a number of protections in the legislation that were designed to weed out fraud and abuse in the system. There are myriad forms of fraud and abuse, and as a result, a number of different provisions were necessary to address them. It appears that most of these have been fairly well targeted and have accomplished their goals.

First, with respect to fraud, a number of new protections were enacted, including tax returns, pay advices, debt audits are coming online now. That seems to have weeded out a lot of fraud.

We have already heard reports on abuse and the role of the means test. Repeat filings seem to be down substantially. In particular, repeat filings were designed solely to take advantage of the automatic stay and prevent legitimate efforts of creditors to foreclose rather than efforts for real bankruptcy relief.

As noted, domestic support creditors have substantially had their position increased, and it seems to have eliminated some of those strategic filings.

Finally, if I may have 20 seconds to conclude my thoughts.

Chairman SESSIONS. Please take your time.

Mr. ZYWICKI. There have been some complaints that there are drafting problems in the legislation. Certainly with a piece of legislation this complicated, you would expect some hiccups and drafting problems. But by any reasonable estimation, it seems that those drafting glitches are less than one would expect from such a provision.

Second, Congress' intent was made sufficiently clear, I think, at the time that a lot of those drafting glitches have been solved.

Finally, I think that—or judges have been able to construe the statute. Finally, I think comparing this to the 1978 legislation, which many veterans will recall was struck down as unconstitutional by the U.S. Supreme Court, I have not seen anything to suggest the major constitutional problems that were raised by the 1978 code, for instance. We may have some issues that are being worked out with this, but nothing like the serious and substantial long-lasting problem that arose in efforts to implement the 1978 code.

Thank you.

[The prepared statement of Mr. Zywicki appears as a submission for the record.]

Chairman SESSIONS. Thank you.

Congressman Bartlett?

STATEMENT OF STEVE BARTLETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL SERVICES ROUNDTABLE, WASHINGTON, D.C.

Mr. BARTLETT. Thank you, Mr. Chairman. I am Steve Bartlett, President of the Financial Services Roundtable and proud University of Texas alum, as well as mayor of Dallas, Texas. I have submitted my entire statement for the record.

The Financial Services Roundtable, as you know, consists of a membership of 100 of the largest integrated financial services companies in the United States and, thus, the American consumer and the health of the American consumer is the lifeblood of our companies, and it is in our best interest to have well-educated consumers who manage debt prudently. That is just what Public Law 109–8 helps to do. The law is just over 1 year old.

So far, from the perspective of the American consumer and the economy, the new bankruptcy reform law is working quite well. Bankruptcy filings are down. More Americans than ever are getting credit counseling, and as a result, consumers are better educated about prudent financial management than they have ever been. Let me cite some statistics.

Consumer bankruptcy filing rates have dropped dramatically from an annualized rate of about 1.5 million to 600,000 in 1 year. More consumers are choosing repayment plans under Chapter 13, about 40 percent of filings as opposed to 27 percent prior. And here is the deal on the credit counseling. There were 157,000 total credit counseling sessions at Justice Department-certified agencies in October of 2006, and that compares to 57,000 a year ago on an annualized rate in 2005. Now, that is 157,000 to 57,000. Indeed, there were 73,000 in October for traditional credit counseling. So not only has the new law introduced the new concept of pre-discharge counseling and pre-bankruptcy counseling, which are good in and of themselves, but it has also introduced the concept to a lot more consumers and made it safer to seek traditional credit counseling, about a 30-percent increase.

These numbers indicate, Mr. Chairman, that the means testing and the pre-bankruptcy credit counseling mandate are working. Recall that the principal policy objective of bankruptcy reform was to say that people who can repay some or all of their debts ought to do so, and that seems to be happening under the new law.

Now, one major result of bankruptcy reform is this increased credit counseling. We think that is a positive. Is it perfect? Of course not. But credit counseling can and does help consumers to keep out—helps keep them from getting into financial trouble, and for those consumers for whom bankruptcy is the appropriate and the last available option, credit counseling helps keep those consumers out of financial trouble into the future.

The Justice Department has estimated that some 10 percent of consumers who get pre-bankruptcy counseling do not file for bankruptcy. And recall there is that much larger number that come in for traditional credit counseling and find ways out of their difficulty. Counseling is now widely available from numerous sources through multiple channels, and that was the intent of the law: in-person counseling, telephone counseling, and Internet counseling.

I must say, Mr. Chairman, that the nonprofit agencies that are members of both AICCA that Mr. Jones represents and NFCC have really stepped up to the plate to make this law work. They have applied in large numbers to become certified agencies. They have sacrificed. They have stepped up to live by ethical requirements as established by the Justice Department, as, in fact, they always had. We are better off today for the efforts of those agencies and their dedicated professionals who work day in and day out to help these consumers. It is clear that these agencies are acting as Congress had intended.

It is also important to note that the Justice Department certification itself is a significant enhancement to the law which had not existed. I don't know whether this was an unintended consequence, but it is a consequence of great note. For the first time, consumers can know who are the good-guy agencies as distinguished from the bad-guy agencies and have some reliance on being able to go to certified agencies, agencies certified by the U.S. Justice Department that these are agencies that they can rely on. That in and of itself improves the system rather dramatically.

Now, Mr. Chairman, we believe that the counseling system can be improved. We have, in fact, submitted some specific suggestions to the Justice Department which have been made a part of this record. The most important suggestion, it seems to me, is that pre-bankruptcy certificates could be extended for a year—could be good for a year prior to pre-bankruptcy filing as opposed to just the 6 months. We think that gives consumers a much larger window of time to consider their options and try to work themselves out of trouble. We think that each of the issues that we have raised and others have raised can be corrected in regulatory action.

So, Mr. Chairman, so far, so good. Bankruptcy reform is working. Prior to the enactment of this law, Congress had not reformed bankruptcy laws significantly since 1978. We need to let the law mature before considering any legislative changes. Congress did the right thing for the consumer and the economy in passing this bankruptcy reform. It is now time to make sure the legislative success is correctly implemented.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Bartlett appears as a submission for the record.]

Chairman SESSIONS. Thank you.

Mr. Jones?

STATEMENT OF DAVID C. JONES, PRESIDENT, ASSOCIATION OF INDEPENDENT CONSUMER CREDIT COUNSELING AGENCIES, POINCIANA, FLORIDA

Mr. JONES. Thank you, Mr. Chairman. I am very happy to address the future viability and progress of the BAPCPA over the last year.

Chairman SESSIONS. Is your microphone on?

Mr. JONES. Maybe I turned it off.

Chairman SESSIONS. That is a little better.

Mr. JONES. I probably did. Well, thank you anyway, and let me restate here. I am very happy to address on behalf of our members the future viability and the progress that has been made over the last year since passage of BAPCPA. We provide counseling and education to millions of U.S. consumers and annually return over $3.2 billion in consumer payments to the Nation's creditors. We deal with a lot of consumers. In addition, we have counseled over 200,000 consumers entering the bankruptcy system to date, and I want to talk about five major areas of concern that we have with the administration of the bankruptcy law.

The first concern I have is the future adequacy of the credit counseling resources. The present number of approved agencies is more than adequate to satisfy the need for pre- bankruptcy counseling currently. However, we have serious concerns about the adequacy of counseling capacity when those filings significantly increase, which they probably will. A surge of capacity in such circumstances could trigger provisions that provide for suspension of the counseling requirement in some judicial districts unnecessarily, and we believe strong efforts should be made to avoid such an outcome.

The second point involves the need to clarify filers' ability to pay. Every approved agency provides mandated counseling at a reasonable fee or provides services without regard to ability to pay that fee. We applaud that criteria, and it is consistent with our own member accreditation standards. However, approved agencies have consistently been offering bankruptcy counseling at a significant financial loss. All the information we have seen indicates the cost of providing a bankruptcy session, in accord with the EOUST criteria, is about 50 bucks while the average payment for such a session turns out to be around $32. Currently approved agencies simply will not be able to continue participation over the long term if the provision of BAPCPA counseling does not become at least a break-even proposition. Now, that could change if the population changes, the bankruptcy population changes and more people select debt repayment plans, or it could change if we got some kind of relief from the EOUST on whether somebody who clearly can pay a fee could be required to pay that fee.

The third point involves the question of what constitutes legal advice. It would seem obvious that a counselor assisting a financially troubled debtor needs to be able to advise that individual that bankruptcy is one available option; that bankruptcy may offer either liquidation or partial repayment of debts, depending on circumstances; and that a bankruptcy will remain on the credit report for a decade. These factual matters can be readily distinguished from the giving of legal advice.

BAPCPA's legislative history supports the view that Congress intended to ensure that debtors receive informed and objective advice from two separate sources: an approved CCA and an attorney. Assuming that the EOUST addresses the proper pre-bankruptcy roles of attorneys and CCAs in the more comprehensive regulations it plans to propose, we would urge it to clarify the legal and ethical boundaries for interaction between these two professions.

Fourth, approved agency removal issues. The EOUST has proposed that, in certain circumstances, its decision to revoke an agency's approved status need not wait upon exhaustion of its opportunity for administrative review but may be effected immediately by an interim directive. We hope that this short-circuiting of the administrative appeals process will be rare and take strong exception to the EOUST's proposal.

It is clear that, while nonprofit status is required to become an approved CCA, tax-exempt status is not. Because tax-exempt status is not a statutory requirement, the EOUST should not deprive an approved CCA of its appeals right simply because it might lose or has lost that status.

My final point involves debt settlement plans, something that really has not been broached and is part of the code. Section 502(k) allows the court, on a debtor's motion and after a hearing, to reduce a claim by up to 20 percent if the creditor unreasonably refused to negotiate a reasonable alternative repayment schedule proposed in a timely manner. This provision potentially provides approved agencies with the ability, and possibly the obligation, to negotiate a debt settlement plan on behalf of the debtor who lacks the financial resources to complete a 100-percent repayment plan.

Given the potential of debt settlement plans to provide benefits to both debtors and creditors, as well as the new responsibility thrust upon agencies by Section 502(k), we believe that the EOUST should address this topic in its more comprehensive proposed regulations.

Overall, we believe that the mandated credit counseling has been successful. It is, in my view, a boon to consumers. It is having a very beneficial effect on bankruptcy petitioners. They get possible alternatives, and their understanding of specific personal financial issues is improved.

Thank you for letting us share these views, and I would be happy to answer any questions.

[The prepared statement of Mr. Jones appears as a submission for the record.]

Chairman SESSIONS. Thank you.

Judge Newsome?

STATEMENT OF RANDALL J. NEWSOME, CHIEF JUDGE, U.S. BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, OAKLAND, CALIFORNIA

Judge NEWSOME. Good afternoon, Mr. Chairman. The Bankruptcy Abuse Prevention and Consumer Protection Act has now been in effect for about a year, and as I understand it, the purpose of this hearing is to give the Act its first annual check-up.

As I said in my written testimony, we really do not have enough data from which to draw conclusions about the effects of the bill, but I have to say, listening to Professor Zywicki, it sounds like he has data that I have not seen and that I would be very interested in seeing as to the effect on women and the access to the system and so forth.

Putting all that aside—and, by the way, I should note that in our district, in the Northern District of California, we have had probably 7,000 cases filed this calendar year. We have had one motion to dismiss under the means test. Just one. And that was withdrawn by the U.S. Trustee.

Putting all that aside, I still believe very strongly, as I always have in this debate, that while Congress can change the law, it cannot change the math. And the numbers appear to be dripping with red ink for millions of consumers in this country. Maybe I just scare easily, but I find those numbers shocking. The median household income in the United States has essentially been flat since 1989, but outstanding consumer debt has tripled in those 17 years. Revolving consumer debt has quadrupled during that same period, and those numbers don't include mortgage debt, the median amount of which rose some 27 percent between 2001 and 2004.

Now, it does not matter how fast your house is appreciating, and right now they do not appear to be appreciating much at all, if at all. If you continue to lean up to the hilt to spend more or to simply make ends meet or, worse yet, to pay off the debt you have already got so you can spend even more, that is a losing proposition.

Eventually, after consumers have burned all the furniture, to use a bit of bankruptcy jargon—in other words, squeezed every dollar out of their houses and out of their other assets and out of their credit cards and their home equity lines—the debt bubble will burst. And once it does, it will be critical to the health of the economy that those consumers not be trapped underneath all of that debt. If the country is to weather what may be a perfect financial storm, it will need the most efficient and accessible bankruptcy system we can devise so that consumers can reorganize their finances and get back on their feet. The present law should be fine-tuned to prepare us for this eventuality, or any other.

I think I can safely say that all of the bankruptcy judges—for whom I am not speaking here today—in this country would be glad to assist the Subcommittee in this endeavor in any way you see fit. Thank you for this opportunity to be heard.

[The prepared statement of Judge Newsome appears as a submission for the record.]

Chairman SESSIONS. Thank you very much. Professor Lawless?

STATEMENT OF ROBERT LAWLESS, PROFESSOR, UNIVERSITY OF ILLINOIS COLLEGE OF LAW, CHAMPAIGN, ILLINOIS

Mr. LAWLESS. Thank you, Mr. Chairman, and thank you for inviting me to be here today. As you mentioned, I teach and write about bankruptcy law at the University of Illinois, and in my scholarly work, I base that on Government data but also on publicly available court files, as well as talking to debtors and interviews with the debtors and the people who file for bankruptcy. That research had led me to conclude that the abuse that many saw in the bankruptcy system before the passage of the law was not there. I still think it is not there. Nevertheless, we have got the law, and we have got the law to deal with. In the law, there are many new provisions that would benefit banks, credit card companies, car lenders, landlords—just about anyone that loans consumers money.

Congress passed the law and the President signed it despite the expert advice of those who work in the bankruptcy field—bankruptcy lawyers, bankruptcy professors, and bankruptcy judges. Interest rates have not gone down. According to the Federal Reserve, interest rates on personal loans and credit cards are the same today as they were just before BAPCPA, to use the term that we have been calling it, went into effect.

What about credit card fees? Credit card fees continue to rise. For the 3 months ended September 30th of this year, Citigroup reported it made $1.3 billion in fees on credit and bank cards, an 8-percent increase over the same time period 1 year previous. In October, Wells Fargo announced it was increasing late fees on its largest credit card accounts, the majority of its accounts, by 11 percent.

On the 1-year anniversary of the new bankruptcy law—and we have heard a lot of talk about that here today—there has been a dramatic decline in bankruptcy filings. And it is certainly true that bankruptcy filings have declined. The numbers are still coming in. It depends upon what you compare it to, but maybe about one-half I think is a rough guess as to where they are from before the law passed.

Some critics of the new law predicted that this dip is going to be short-lived and we are going to see bankruptcy filings return to their previous levels. Frankly, my expert opinion is that it is just too early to tell whether the law has led to a permanent readjustment of the bankruptcy filing rate.

There is some reason to believe, however, that bankruptcy filings may return to their previous levels. Bankruptcy filings are trending upwards. But, in any event, I think that we are confusing a treatment here—bankruptcy—for a problem—financial distress. It is somewhat like confusing the hospital with the underlying disease. What the new law did is it made it more difficult for people to get into bankruptcy court and get less effective relief once they get there. By shutting off the hospital, nothing has been done, as Judge Newsome just referred to, to deal with the pressing needs of the American middle class. And what we know from previous scholarly research is that bankruptcy is a middle-class phenomenon.

Of course, bankruptcy filing rates have gone down. The onerous new requirements on attorneys who represent consumers have increased their costs. It is not a matter of trying to increase or maintain profits. Attorneys have more to do under the new law. They have more investigation to do. They have more responsibilities. It is not surprising that costs have gone up. I think based upon some preliminary research and looking at court files, attorneys' fees may have risen—and I want to emphasize "may"—50 to 100 percent in some areas.

Just as Americans drive less when the cost of gasoline rises, they are going to file bankruptcy less when the cost of filing bankruptcy rises. And just like rises in the cost of gasoline fall hardest on middle-class working Americans, rises in the cost of bankruptcy fall hardest on them as well.

There is reason to believe consumer financial distress is on the rise. Judge Newsome referred to a figure in 2004. According to the Federal Reserve, the most recent figures show that home mortgage debt today, in 2006, is 75 percent higher than it was 5 years ago; 300,000 properties entered some stage of foreclosure in the third quarter of 2006, an increase of 43 percent compared to the same time 1 year ago.

The Boston Globe and New York Times have run multi-part stories about increasingly harsh debt collection tactics by consumer debt collectors. And with consumers owing more and with a less accessible bankruptcy system, it is not surprising that debt collectors have turned the screws.

From bankruptcy courts and petitioners, we are hearing stories about the law's harsh application. A disabled debtor who had not worked in years and had not had enough income to file a tax return since the 1970s was faced with a trustee's demand that he produce those 30-year-old tax returns because the law requires the debtor to produce the most recently filed return.

Two judges have interpreted the new law to prohibit filing bankruptcy on the day credit counseling is received. Another judge was faced with the situation of a debtor who had received credit counseling within 190 days rather than 180 days before filing bankruptcy. And I would support the extension of the credit counseling eligibility to 1 year. In dismissing that case where the credit counseling was received 190 days, just 10 days too long before, the debtors had tried to use that extra time to negotiate with their creditor. Nevertheless, the judge felt he had no choice but to dismiss. As the judge wrote, "The Court is obliged to dismiss regardless of the fact that debtors 'almost' met the requirements of the statute, regardless of the fact that debtors seemed to have satisfied Congressional objectives that were enacted as part of the statute, regardless of the fact that no one contends that debtors were not in good faith, and regardless of the fact that no one contends they did not make a zealous effort to accomplish the Congressional objective, and regardless of the fact that no useful purpose will apparently be served by dismissal." So there is one example of debtors who needed bankruptcy court and were cutoff from access to it because of the new law.

I thank you again for allowing me to speak to you today.

[The prepared statement of Mr. Lawless appears as a submission for the record.]

Chairman SESSIONS. I can give them a useful purpose for following the standard rule, which has a utility all of its own. But I guess judges can express their opinions and I can express mine.

Mr. Hildebrand?

STATEMENT OF HENRY E. HILDEBRAND III, CHAPTER 13 STANDING TRUSTEE, MIDDLE DISTRICT OF TENNESSEE, NASHVILLE, TENNESSEE

Mr. HILDEBRAND. Thank you, Mr. Chairman. I am a Chapter 13 trustee in Nashville, Tennessee, and as a Chapter 13 trustee, what the trustees essentially are is the drive shaft of the engine that moves bankruptcy. We are the boots on the ground in the bankruptcy battles. We take positions, we advocate, but we also preserve the integrity of the system. We believe that is our task.

As Chapter 13 trustees—and you mentioned this in your opening remarks—Chapter 13 does pay debt back. It is the mechanism that I heard people from Congress state. We wanted people to be able to recognize that Chapter 13 can be a useful tool to repay debt.

Chairman SESSIONS. Mr. Hildebrand, would you just explain for people who may be listening here the difference in Chapter 7 and Chapter 13, as simply and as briefly as you can?

Mr. HILDEBRAND. Simply, Chapter 7 is the liquidation of available non-exempt assets to satisfy debts. It is what you think of in bankruptcy, take all of the non-exempt assets, sell them at auction, and divide the proceeds. And, of course—

Chairman SESSIONS. And wipe out all your debts.

Mr. HILDEBRAND. Wipe out most of the debts. There are less than there used to be. That is what people think of, and 98 percent of the bankruptcies that are filed fall into that category. Chapter 13 is the alternative. It is proposing a plan to repay the debts as best you can over a period of 3 to 5 years under the supervision of a court and a trustee. That in essence says what it is.

Chairman SESSIONS. If the judge finds he can only pay part of the debts, then he would pay only part of the debts.

Mr. HILDEBRAND. That is correct, Mr. Chairman. It is designed to be a manageable and adjustable tool to fit what debtors need and what families need in order to survive.

Chairman SESSIONS. And collectors cannot call, they cannot file lawsuits, you cannot be harassed about paying debts.

Mr. HILDEBRAND. We think they are still protected by the automatic stay, although there are some cases that lead that into question because of the new law. But while they are in that, then that is correct; they are protected. And we do pay substantial amounts back. I mentioned—as you mentioned, I am disbursing—just one trustee now out of 210, I am disbursing $150 million a year back to the community, back to the hospitals and the doctors and the shopkeepers that extended credit, as well as the auto lenders and everyone else.

But we see what is going on. We have been charged with the responsibility of divining what was intended by the law, but all we have really to go on is the text—the text that was put into the statute. And we are somewhat mystified by some of the text, and as a consequence, we are seeing inconsistent positions and inconsistent decisions coming down from the court. And if there is a message I could deliver to this body, it is: Help us. Help us figure out what the intent was, and if the words are wrong, then we need to fix the words. And I encourage you, if there is an iteration, to change the words, that you consult with those of us who are in the trenches, those of us who are meeting with debtors. Yesterday I met with 50 families. Tomorrow I will meet with 50 more. That is my job. If you meet with us, then we should be able to assist you in doing that and reaching that goal.

It is a little bit like—the crafting of this law, we think, is a little bit like crafting a health care system and not talking to any doctors. So we encourage you, if you do that, to do that.

I would like to take just a moment to mention one thing that you mentioned and it was the focus of your questions to the Director, and that is the means test. Now, the means test in Chapter 7, as you pointed out, Senator, is to decide who has the capacity to pay and who doesn't and who ought to be directed into 13. But what happened in Chapter 13 was that the means test was grafted in to figure out how much a debtor has to pay, not whether they can pay but how much. And we are struggling with what that means. And courts are 180 degrees diametrically opposed on what that means.

For example, you defined the debtor's income as the average over the 6 months prior to filing. So the debtor that is unemployed for the 6 months before filing but now has a great job, maybe a neurosurgeon, would pay nothing because Congress has defined his income as nothing. And then the sadder side is where the debtor has a great job and now has been laid off. But Congress has said because of the definition of this current monthly income that he can afford to pay a lot, when in reality he cannot.

We are stymied with this. The ability to deduct from what you can pay to figure this number the payments you make on secured debt would allow an above-median-income debtor to pay for the expensive automobile, the vacation home—all of those things that under prior law trustees would challenge, would fight, and would bring it to the court.

If there is one thing that we can ask you to look at, it would be to look at the all-disposable-income test; also to encourage you to look at providing to us the tools to be able to do that, so to make certain that trustees have the resources for staff, for training, and to make sure the system does work.

Thank you for the opportunity to speak.

[The prepared statement of Mr. Hildebrand appears as a submission for the record.]

Chairman SESSIONS. Very good. I do absolutely feel that we have a responsibility to listen to people who practice it, and things that do not make sense resulting in injustices we should listen and fix, because this is our Federal court system and Congress is creating it and we need to make it work right.

I would appreciate it if you would share in some detail those problems. I know there are some in your written statement, but more detail about that and maybe your suggestions for reform.

Mr. HILDEBRAND. We would be delighted to do that, Senator.

Chairman SESSIONS. Let's see. We have a lot of interesting issues, and I will not go into them all. But, Mr. Zywicki, I became convinced—you made reference to it in your statement—that there was a generated system to create bankruptcy filings simply to get stays of eviction for people. We had the ads in the newspapers, "Call us. Stop your eviction." And when they got there, it was basically file bankruptcy. We took some steps toward ending that abuse, which I thought was a real abuse.

Do you think that is working? You indicated you thought it may be.

Mr. ZYWICKI. Senator, from what I can tell, one of the contributions to decreasing bankruptcy filing rates is a decrease in repeat filings generally. That could be from a number of reasons. There was an extension of the waiting period for receiving a discharge again. There is now a provision for counseling within bankruptcy for financial education that will hopefully reduce bankruptcy filings in the long run. But I think a substantial reason from what I can tell has been a reduction in repeat filings of the kind that you describe, which is the provisions in particular that expedite the process for lifting the automatic stay for somebody who is filing bankruptcy repeatedly just to prevent foreclosure without any purpose to actually try to work a repayment plan or discharge their debts. That, based on what I understand, has had a substantial increase in reducing those sorts of filings.

Chairman SESSIONS. And I will ask you, Mr. Bartlett, you were critics of the existing system and supportive of reform. One of the things these forms and some of the more intensive review of the procedures was designed to do is to help avoid fraud. The person would hide assets or maybe feel like they could file bankruptcy and beat the system in some fashion and not put all their assets back into the pot for creditors that were required to go there.

Do you think in tightening up some of these provisions that that may have led people to choose not to file bankruptcy? Could that be a factor in the decline in filing?

Mr. BARTLETT. Well, Mr. Chairman, I think it was. I think that the fraud has clearly been reduced. I was never one to think that the excess bankruptcy filings were the result of fraud, but it was clearly there. And I think fraud in large part has been driven out of the system by the reforms that the law has made.

But I think equally important has been the awareness by the consumer through a number of medium, including reading the newspapers, seeing reports of it, the mymoneymanagement.net that my organization has put up on the Web, and just simply talking with their bankruptcy attorneys and the counselors, an awareness that bankruptcy is a last resort, not a first resort, that many times there are a lot better options and that, in fact, if you can pay some or all of your debts, you ought to do so. Not only are you better off, but the overall economy is better off.

So I think the idea of putting in the whole—the whole law is based upon the concept that if you can pay some or all of your debts, you ought to do so. And that has been the principal cause, I think, of the reduction of bankruptcy filings.

Chairman SESSIONS. But, in truth, like you said, most people filed honestly in bankruptcy. Most people, I know Judge Newsome would know and Mr. Hildebrand would know, are justified. They have low incomes. They are below median income. And so for them, not much has changed, has it, Judge Newsome?

Judge NEWSOME. A lot has changed.

Chairman SESSIONS. What has changed?

Judge NEWSOME. What has changed is they have to file at least eight new sets of documents to get any kind of bankruptcy relief at all, and that is expensive. When you are a lawyer and you have got to get your client to go out and find those documents—these people are not in bankruptcy by accident many times. It is not because they are great recordkeepers. They are in bankruptcy because they are very unsophisticated people, they do not keep their records very well, and the lawyer has to go out and spend a lot of time with these people trying to get them to gather up the documents they need. Regardless of whether they make nothing but Social Security every year, they have got to do it.

Chairman SESSIONS. Well, they have to produce documents.

Judge NEWSOME. Absolutely. They have always had to produce documents.

Chairman SESSIONS. But if you want to come in and not pay somebody you owe a debt to, shouldn't you be required to at least show you do not have income sufficient to pay them or assets sufficient to pay them?

Judge NEWSOME. Absolutely. And Schedule I of Form 6 has always done, and if we think now—

Chairman SESSIONS. Well, that is—Congress did not agree. All I am saying is Congress thought the tax returns—tax returns and what other documents are required?

Judge NEWSOME. And, Senator, I lost so I am not here to argue with you about the law. If we got it, we are going to enforce it. That is our job.

Chairman SESSIONS. Thank you.

Judge NEWSOME. But you need tax returns, you need pay stubs, you need, of course, the credit counseling certificate. You have to fill out the first 15 lines of a 58-line form, regardless of whether you make just Social Security income, regardless of whether you could establish perhaps by one simple document, or there is no reason to believe that you have any other income, you have to do the same thing everybody else has to do regardless of what your circumstance. That is the one-size-fits-all problem.

Chairman SESSIONS. Well, when I was a Federal prosecutor, sometimes that "no false statement to the Government" is the thing that becomes prosecutable. You ask these multiple questions. If the answer is no, you put no. If you do not have it, you put no. And then you find out that they lied and they got 40 acres out here—

Judge NEWSOME. Put them in jail, Senator. I have always said that is the way to get the system cleaned up.

Chairman SESSIONS. Well, you cannot prove it sometimes. I am just saying there is nothing wrong with asking some questions so that when the person goes through the process, they have had to adequately disclose their assets, I think.

Mr. Hildebrand, you have been through that.

Mr. HILDEBRAND. I agree with what you just said. I believe it is appropriate for debtors to disclose when asked, and I have always been able to do that. In fact, by providing to me the requirement, which I believe I have, to check four different numbers for income—I am looking at the B22 form that you mentioned, the current monthly income; I am looking at what the debtors said on Schedule I, which has always been there; I am looking at their pay advices that they have to file for the 60 days before they file; and I am looking at their tax return. So I have four numbers that I have to try and reconcile and ask the debtor: Why is your taxable income, gross income of your tax return so much different than your last two pay stubs? And why is that different than your current monthly income? And I am not saying that is wrong.

Chairman SESSIONS. What do you learn when you ask that?

Mr. HILDEBRAND. Well, I tell you, there is one thing, and you probably knew this as a Federal prosecutor. Sometimes you can look at somebody and you know when they are lying. You know it. And after 25 years of being a trustee, I got pretty good at looking and seeing that that is a real Rolex on your wrist. And you instinctively can tell that. I have tools now that can help me, but I do not need them in every case. I know the debtor that is 68 years old that came before me yesterday, who has Social Security income, they cannot find their last tax return, and they have to pay now to get some way for somebody to help them dig that out.

Now, I wish that there was a way that it could not be applied to them. But it also angers me—and I am glad to have the tools to do that—when I see that person in the Chapter 13 trying to save their house, but then the next person comes up and they have got a third car they do not need and they have got a big screen TV and they have got a hot tub that they get to keep and they get to pay for because of the way that I mentioned that the disposable income test is written. And that makes me angry. I wish I had the tools to fix that.

Chairman SESSIONS. You are right. there is a tension. We do not, Judge, want to have more burdens than we need. That is a valid concern. But we do need to make sure that the perception that bankruptcy is an invitation to fraud, we need to end that perception, and it was not as bad as some people thought before, but hopefully this will help.

Briefly, Mr. Hildebrand, those that make above the median income are often required to go into Chapter 13. Explain to us why that is not so bad and why many, many people file Chapter 13 anyway when they could file Chapter 7.

Mr. HILDEBRAND. Where you come from, where I come from, and in Georgia and in North Carolina and in Texas, there are enormous numbers of people that are filing Chapter 13, not because they have to but because they want to. I believe this is a bar issue, the debtor's bar. The more that the debtor's bar becomes sophisticated and educated, the better tool that Chapter 13 can be.

Now, you did take away in the law some of the incentives for people to file Chapter 13.

Chairman SESSIONS. The cramdown was one of them.

Mr. HILDEBRAND. The cramdown.

Chairman SESSIONS. Some. We did not eliminate it.

Mr. HILDEBRAND. The 910 days is—you used to have to pay for the car more. I look at that as a loss to the medical community and the other creditors who are getting less as a result of that benefit to the car. But in the long run, Chapter 13 allows you to keep your house, restructure your debts, pay what you can afford to pay, and if it does not work, if for some reason you cannot do it, you can convert to Chapter 7, at which point you can demonstrate to the United States Trustee, "I really tried, and this is why I could not do the Chapter 13."

Chairman SESSIONS. I could not agree more about that.

Judge Newsome and Professor Lawless, you expressed concern that continually arose in the debate over bankruptcy that I would like for you to address, although I think you do not—I mean, my view is firm that you do not fix too much borrowing, you do not fix too much mortgage on your home by making it easier to defraud your creditors or not pay your creditors. But tell me, how could we—what concerns do you have and what are some steps Congress might consider to avoid people who are financially illiterate from being sucked into too much debt? And I would just say this: I do not know that—you know, if they were not being offered credit cards, we would be suing these banks and all for not offering credit to people who have a realistic chance to pay back. We would say you are not doing enough. But how could we improve that? We did some steps in this bill that required disclosure, but it is not—let me just say this to you: This is a Banking Committee issue. Credit, lending, is not to be solved in a court procedure bankruptcy bill, in my view.

Judge NEWSOME. I do not think you are going to like what I am going to say, and I may have to have an escort out of the building, given who is in the room. But one of the things that aggravates me greatly is when I look at a set of bankruptcy schedules and I see five credit cards or four credit cards or even three credit cards with $5,000 or $10,000 limits issued by the same bank. I see 25 or 35 or—it is nothing anymore. It used to be in 1982 if you saw two or three bank cards on the schedule, that was about the max. Very rarely did you ever see more than two or three cards. Now, it is nothing to see 40 cards on a set of schedules, $200,000 in credit card debt.

If it were up to me, I would say, look, if you issue more than one card to anybody with more credit than they should have, it is your tough luck. Let's let the marketplace do its work. If you do not like the way the loan came out this time because they defaulted, then do not do it again. The same thing goes for when you have got three or four—you know, you have got 25—these people can all keep track of how much credit outstanding these people have or what is available to them.

What if you said that if you issue a credit card into a totally insolvent situation, you cannot object to the dischargeability of that debt in the bankruptcy. Now, I know that is going to go over like a lead balloon around here, but really, I think that is one way of deterring lenders, putting a little more moral hazard into the lending practices of the credit card companies.

Mr. LAWLESS. I agree with just about everything Judge Newsome said, and I would add that I think you have got to think about bankruptcy as part of the consumer credit system. We have been talking here today like—

Chairman SESSIONS. I think bankruptcy is a court system that allows people to not pay their credit card debts.

Mr. LAWLESS. Well, I agree—

Chairman SESSIONS. Or any other debts, if they so qualify.

Mr. LAWLESS. Well, I agree with that, and what I was going to say is that we are talking about bankruptcy like it is some end in and of itself as opposed to a means. And I think you asked a very good question about what else Congress can do, and I think Congress should look at restrictions on consumer credit lending, more regulation along the lines of limits on marketing to college students, limits on marketing to minors, limits on being able to send credit card solicitations to people who have just come out of bankruptcy.

We might want to think about some national usury law. I am very reluctant to propose usury caps, but something at a very high level because we see things, and Congress just passed and I was very happy to see limits on payday lending around military bases, and something with very high caps that would—usury caps that would address some of the grossest abuses in the consumer lending industry.

There are some other things that I think would work, to look at regulating things like universal default clauses, regulating some of the ability of the credit card companies to change provisions in their contracts at will with consumers. It is a one-sided system where the credit card companies get to call all the shots and get to change the rules pretty much at will.

Chairman SESSIONS. Thank you.

Mr. Bartlett, I always felt that it really wasn't oppressing a person to give them credit cards and let them use them, but how do you respond to that? That to me has been one of the things that has made it difficult to pass bankruptcy reform, which, as I made clear, I think is sort of not part of our—shouldn't be much a part of our discussion. But how would you answer that?

Mr. BARTLETT. Well, Mr. Chairman, you are correct that bankruptcy is a judicial process that is available for people who are totally insolvent and cannot pay their debts. And bankruptcy should not be and under this new law is not available for people who can pay, who can repay some or all of their debts.

Mr. Chairman, so far as the issuance of credit, I would say to the professor that proposals for usury limits and for Government-allocated credit and for some Government agency to decide who gets credit and who does not has been a system that has been tried in other countries. It has been tried from time to time with various laws around here. And always it has been an abysmal failure because when the Government starts allocating credit or allocating other things, well, then, there becomes a shortage and, in fact, you eliminate both fairness and you eliminate economic growth.

The fact is the competitive marketplace is what issues credit today. By and large, the issuers of credit offer credit to people on terms that they can repay, and they repay it, and that is one of the things that has generated some of the economic prosperity that we have.

The Federal Reserve just did a study on one of the points that Judge Newsome raised, and they concluded the opposite. They concluded that since 1970 the level of household debt service has stayed relatively flat, that it has risen only by a very small amount. Obviously, you can pick up statistics about what has gone up and what has gone down. But, by and large, the system works quite well.

The idea of imposing price controls, which is oftentimes trotted out in Washington and elsewhere, or usury limits, that is a system that is doomed to failure, and it just simply—it is an allocation-of-credit system in which the Government will decide who gets to buy a new car or who gets to buy a new house or who gets to buy anything else. And it is a system that is doomed to failure.

I think a system in which the companies compete, lenders compete against one another and they compete ferociously brings the lowest cost, the highest efficiency, and the best allocation of credit. And there is a bankruptcy system, but that should be limited to people who otherwise are insolvent and not able to pay their debts.

Chairman SESSIONS. Mr. Zywicki, do you want to comment on that? Any thoughts?

Mr. ZYWICKI. Sure, I think there are a couple of points.

First, obviously just by way of background, one of the reasons why people end up—sometimes people are issued more than one credit card by a lender, typically what has happened over the past decade or so is that because of mergers between banks and accumulation of credit card portfolios. Basically what happens is a person may have a credit card from two different banks. The two banks merge. They have got two credit cards then from the same bank. And then the question becomes: Should the bank cancel one of them? Which is a very different question from the one that I think was posed earlier. That seems to be something that has become more common.

With respect to overindebtedness, I think in usury regulations there is—two observations for here. First, as Mr. Bartlett notes and as I have noted in some of my scholarship which is cited in my testimony, the debt service ratio has remained basically constant over the past 25 years, the debt service ratio basically being what is your ability to pay your bills every month as they come due—your credit card payments, your car loan, that sort of thing.

That number has remained basically constant for 25 years. Why? Because interest rates have been very low for the past decade or so. If interest rates go down, people borrow more. Their monthly payments remain the same. They can pay more for a house.

It turns out also housing values have gone up much faster than mortgage debt has. It turns out that the biggest polarization in wealth in America today does not seem to be between rich and poor but, rather, between homeowners and non-homeowners. Why is that? Basically we have seen this expansion of credit to lower-income borrowers. Homeownership in America is at an all-time high. About 69 percent of families own their homes now, an increase of 5 percent over the past decade. Most of those people paid their loans. Most of those people are sitting on an incredibly valuable asset that they could not have gotten access to in the past and will not get access to in the future if impose wrong-headed limits on credit.

Finally, I think we have to keep in mind that one reason why people borrow and one reason why people may borrow too much is because of the bankruptcy laws. If the bankruptcy laws give you a free pass, people are more willing to borrow more. People may be more willing to live beyond their means if the bankruptcy laws give you a free pass. If the bankruptcy laws instead ask you to repay some of that if you can, people may have a very different attitude toward their borrowing. That is not saying that everybody does that. Most people are in bankruptcy because of job loss or something like that. But it is certainly the case that people's behavior will be affected by the bankruptcy laws themselves.

Chairman SESSIONS. Well, I am glad we just had that discussion because it is a concern, it is a national concern that people are often getting in too much debt. And I think we have to adhere to the ideal that every American, when they take a credit card or sign up for a mortgage, is a responsible decisionmaker. And sad to say, people are irresponsible. Sad to say, if they can get their hands on two credit cards, they may run both to the limit and get so deep in debt they cannot get their way out of it. But when they are bankrupt, Mr. Bartlett, the bank does not get paid. Isn't that correct? So you have a self-interest in not allowing the debts to get too high, else you take the big hit. You are the one that takes the hit.

Mr. BARTLETT. Mr. Chairman, we are the other victims here, the victims of the financial loss. We spend a lot of—"we" meaning our companies and the industry spends a lot, invests a lot of time and resources and money to try to educate consumers, to counsel with them, to provide resources so that they understand how to manage debt.

We just opened up this new website, as I mentioned a minute ago. One of the things that does is to invite consumers to reach out to a certified credit counselor. We now have a list of certified, good-guy, Good Housekeeping Seal credit counselors that we can refer consumers to, and that helps a lot. That gives us a third party that we can send people to at the earliest signs of difficulties so that they can work their way out long before bankruptcy.

I would also just note, Mr. Chairman, one piece of information. The other trade association, the companion with Mr. Jones, is NFCC. They just did a survey of their incoming customers or consumers that they counsel with in pre-bankruptcy counseling, and according to those consumers, 67 percent of them were there because of poor money management decisions. That is self-identified. And 29 percent were there as a result of a job loss, and about 2 percent were there because of a medical loss or a medical difficulty.

So, Mr. Chairman, in most cases, about two-thirds, it always comes down to poor management, poor decisions of money management, about two-thirds, and that is why we offer a lot of counseling to try to help people make better decisions.

Chairman SESSIONS. I think we ought to teach people to be frugal. There is nothing wrong with watching how you spend your money. And it is easy today to be tempted and get out of control and overspend.

My own view is that one of the greatest things about America is an average working person can get to the end of the month, have no money, have a flat tire, has no money and has got a piece of plastic and can go get the tire fixed and try to pay it back later. That is one of the fabulous things about this country.

Another fabulous thing about it is that when you go around the world, like I have had the opportunity to do in recent years, particularly in some of the underdeveloped countries, houses are half-built. They do not have windows in them. They will have the roof, and I asked one time about it, and he said, "Well, they don't have money to buy the windows yet. They are saving up to get the windows."

We buy the house and take out a mortgage, and the average guy in America can borrow $100,000 and pay it back at 7 percent or less interest over 30 years and live in the house. What a fabulous thing this is. And I don't think the banks deserve any moral credit for it. They are making money off the loan, or they would not be making it. But the system I think fundamentally works.

And, Mr. Jones, credit counseling—the agency I visited in my hometown of Mobile, they bring the family in, they sit around the table, they decide what the income is. They help them see where they are misspending money, help them figure a way out of it. Sometimes the only way is bankruptcy. But I do think credit counseling plays a good role in this country, and I hope that we can come through some of the difficulties some of your companies have had and reach its fullest potential of helping people void unwise debt expense and work their way out of debt.

Mr. JONES. I could not agree with you more. The problem in this country is not the availability of credit. It is financial illiteracy. And the more we can help people understand how to be good stewards of their family money, the better off we will be.

Chairman SESSIONS. I think that is the purpose behind the Act.

Thank you very, very much. This has been a very good panel. We will have your full statements in the record, and I will just pledge to you that we will continue to look at this. If you have any specific matters that you think should be adjusted in the Act, I would be glad to receive them. And as time goes by, I feel it is our responsibility to evaluate where we are going and fix the problem.

If there is nothing else, we will stand adjourned.

[Whereupon, at 4:37 p.m., the Subcommittee was adjourned.]

[Submissions for the record follow.]

[Additional material is being retained in the Subcommittee files.]

SUBMISSIONS FOR THE RECORD

REPORT ON THE IMPACT OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 ON THE WORKLOAD OF THE FEDERAL JUDICIARY

PREPARED FOR THE
U.S. HOUSE AND SENATE COMMITTEES ON APPROPRIATIONS

ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS
JAMES C. DUFF, DIRECTOR

August 2006

REPORT ON THE IMPACT OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 ON THE WORKLOAD OF THE FEDERAL JUDICIARY

INTRODUCTION

The Administrative Office of the United States Courts has been asked to report on the impact on the federal judiciary caused by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Pub. L. No. 109-8). The request was included in the Conference Report (H. REP. NO. 109-307) accompanying the fiscal year 2006 appropriations legislation for the Departments of Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia, and Independent Agencies. This report responds to the request by describing the additional work that the federal courts have experienced and analyzing the impact of the bankruptcy legislation.

I. THE BANKRUPTCY SYSTEM

Bankruptcy law is governed by title 11 of the U.S. Code, popularly known as the "Bankruptcy Code." The law has two primary purposes: (1) to pay off creditors in a fair and orderly way from the debtor's assets; and (2) to give debtors a "fresh start" by discharging most of their debts, but permitting them to retain a limited amount of specified property. The Code provides for two broad categories of relief — liquidation and reorganization — and it is organized into several chapters, based on the type of debtor and the relief sought.

- Chapter 7 liquidation is the most frequently used chapter in the Code. It provides for an orderly, court-supervised process by which a trustee reduces the debtor's assets to cash (other than certain exempt property) and pays creditors as much as the debtor's assets allow. The great majority of Chapter 7 cases involve individual debtors with "primarily consumer debt," and only a small minority result in payments to creditors. Businesses may also liquidate under Chapter 7.

- Chapter 13 reorganization is available to individuals with regular income who elect to pay off creditors from their future income rather than through liquidation of their property. Chapter 13 is often preferable to Chapter 7 for both debtors and creditors because it enables debtors to retain their property, and because creditors are repaid some or all of the debt.

- Chapter 11 reorganization is used most often to enable a troubled business to continue operating while it formulates a reorganization plan. The plan is subject to a vote by creditors and approval by the bankruptcy court. The business is protected against collection efforts by creditors, but it is subject to bankruptcy court supervision. Under the terms of a reorganization plan, debtors may seek to reduce the amount of their debt, extend the period for repayment, or reduce or restructure the business. (Chapter 11 is available to individuals, but the vast majority of individual debtors file under either Chapter 7 or Chapter 13.)

- Chapter 12 reorganization is similar to Chapter 13, but it is limited to family farmers and family fishermen.
- Chapter 9, which is rarely used, deals with adjustment of debts by municipalities.

The Federal Rules of Bankruptcy Procedure govern procedure in bankruptcy cases. They are drafted by committees of the Judicial Conference and prescribed by the Supreme Court under the Rules Enabling Act.[1]

II. THE BANKRUPTCY LEGISLATION

On April 20, 2005, the President signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act ("the Act"). The 500-plus-page legislation makes substantial changes to the Bankruptcy Code that materially impact the work of the bankruptcy courts and virtually all participants in the bankruptcy system. Among other things, the Act was designed to recover more money for creditors and ensure that debtors who are able to pay back a portion of their debts are not eligible to file for liquidation under Chapter 7. The effective date for most of the provisions of the Act was October 17, 2005 (*i.e.*, 180 days following enactment). Among other things, the new law:

- Requires that debtors complete and pass a complex "means test" to be eligible to file for relief under Chapter 7;
- Specifies that individual debtors may not file under Chapter 7 unless they have received a credit counseling briefing by a nonprofit agency approved by the bankruptcy administrator or U.S. trustee for the district;
- Specifies that Chapter 7 and Chapter 13 debtors may not receive a discharge of their debts unless they have completed a financial management course approved by the bankruptcy administrator or U.S. trustee for the district;
- Makes extensive changes in Chapter 13 that affect the content of repayment plans, timing of confirmation, exceptions from discharge, length of time that the debtor must pay under a plan, and a number of other areas of Chapter 13 practice;

[1] *See* 28 U.S.C. §§ 331 and 2071-2075. Section 2072 specifies that the "Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11." Under Section 2074, rules prescribed by the Judicial Conference before May 1 of each year take effect on December 1 unless Congress acts to reject, modify, or defer them. Sections 331 and 2073 give the Conference the authority to appoint rules committees to prepare and recommend rules to the Supreme Court. These committees are comprised of judges, lawyers, law professors, and government representatives.

- Places additional duties on debtors-in-possession and trustees in Chapter 11 cases, alters the requirements for individual Chapter 11 cases, and expedites the handling of small business Chapter 11 cases;

- Makes Chapter 12 reorganization for family farmers a permanent feature of the Code and adds family fisherman as a new group entitled to use Chapter 12;

- Includes new provisions governing health-care businesses;

- Adds a new chapter 15 to the Code governing cross-border insolvencies that incorporates the Model Law on Cross-Border Insolvency drafted by the U.N. Commission on International Trade Law;

- Amends the appellate structure to allow certain appeals from decisions of bankruptcy judges to be taken directly to the court of appeals;

- Increases bankruptcy filing fees and reapportions them among the Treasury, the Department of Justice, and the judiciary;

- Authorizes bankruptcy courts to waive filing fees for certain low-income debtors;

- Places additional responsibilities on bankruptcy clerks offices and increases the amount of time that judges and clerks have to devote to cases;

- Substantially expands the statutory duties and the responsibilities of bankruptcy administrators and U.S. trustees[2];

- Requires bankruptcy administrators and U.S. trustees to conduct random audits of Chapter 7 and Chapter 13 cases to determine the accuracy, veracity, and completeness of the financial schedules and statements filed by debtors;

- Places additional responsibilities and liabilities on the attorneys for debtors;

- Requires the judiciary to collect and report new statistical data; and

- Authorizes 28 new temporary bankruptcy judgeships, which represents about half the number of bankruptcy judgeships requested by the Judicial Conference.

---

[2] Administration of bankruptcy estates and supervision of bankruptcy trustees are functions performed by bankruptcy administrators and U.S. trustees. Bankruptcy administrators are employees of the judiciary and serve in the six judicial districts of Alabama and North Carolina. U.S. trustees are employees of the Department of Justice and serve in the other judicial districts.

III. IMPACT ON THE COURTS

A. Immediate Workload Crisis

The immediate impact of the Act was an unprecedented number of filings shortly before the October 17, 2005, effective date of the legislation. Many people contemplating bankruptcy feared that the new law would make it more difficult and more expensive to file a case, particularly under Chapter 7, after October 17, 2005. In the 16 days immediately before the Act took effect, more than 600,000 cases were filed in the bankruptcy courts. This was roughly equivalent to having 40 percent of a full year's cases filed in just over two weeks. The staff of the bankruptcy courts, particularly the clerks and deputy clerks, worked on evenings and weekends to serve the filers, process the paperwork, and move these new cases. As a direct result of these extensive filings, the backlogs and pending caseloads of the bankruptcy courts increased for several months after the Act took effect.

B. Ongoing Effect

The Act created many new rights, requirements, obligations, and procedures that have required extensive implementation efforts by the judiciary, both on a national basis and in each local bankruptcy court. On the national level, the legislation has required:

- major changes to the Federal Rules of Bankruptcy Procedure and the official bankruptcy forms,
- issuance of regulations to implement several new statutory provisions,
- development of new administrative procedures in the bankruptcy courts,
- extensive reprogramming of the judiciary's electronic case filing and case management systems,
- collecting and reporting of new bankruptcy statistics,
- development of a new replacement electronic database and statistical infrastructure capable of processing the new statistics,
- extensive expansion of the duties and responsibilities of bankruptcy administrators and U.S. trustees,
- presentation of many new training programs for judges and court staff,
- rewriting of the judiciary's bankruptcy manuals and other publications, and
- revision of the work measurement formulas used to allocate supporting personnel and other resources in the courts.

In addition to implementing these new requirements on a national basis, each individual bankruptcy court has had to interpret and apply the new legislation to individual cases and decide administratively how to implement the new types of proceedings, motions, pleadings, and other papers required by the Act. Much of the work has fallen on the bankruptcy clerks' offices, which have had to make many adjustments in their operations. To assist clerks' offices with their new responsibilities, a Bankruptcy Legislation Working Group, comprised of judges, clerks, and chief deputy clerks, was created and tasked with providing guidance and recommending procedures to the court community. The group developed this guidance and disseminated it to the bankruptcy courts in an easily accessible structure.

C. Long-term Impact

The surge in bankruptcy filings in September and October 2005 created a large amount of work for the bankruptcy courts initially, especially for the bankruptcy clerks and bankruptcy administrators. They were able to manage the increase in large part because of the significant drop in filings after the Act took effect. Most of the work associated with the influx in late 2005 has now been completed, and the bankruptcy courts have largely caught up with the workload.

For the long term, the work of the bankruptcy courts will generally increase on a per-case basis as a result of the Act's many significant changes in bankruptcy law and practice. The preliminary analysis indicates that the Act caused a 10 percent increase in the staffing requirements of the bankruptcy courts. The duties of bankruptcy administrators have increased enormously as a result of the Act, and a new national work measurement survey will begin later this year to measure precisely the increases. The impact on the work of bankruptcy judges is less clear, since only anecdotal information is available at this time. Nevertheless, the Federal Judicial Center will resume its national work measurement survey, probably in 2007, when the law has been clarified and all court procedures fully implemented.

Historically, predicting bankruptcy filings has always been challenging due to the volatility in filing trends. But an additional factor complicates the prediction of the future caseload impact of the Act, namely, the double statistical anomaly of a sharp increase in the number of petitions just before the Act's effective date followed by a sharp drop-off in filings immediately thereafter. About 600,000 petitions were filed in the first 16 days of October 2005. Then in the following seven months, only 250,000 petitions were filed. Most of the petitions that were filed just before the October 17, 2005, deadline would likely have been filed in 2006, but for the Act. As more months go by, filings may increase again because consumers will continue to experience the kinds of financial difficulties that lead them to file for bankruptcy — overspending, loss of employment, loss of health insurance, major illness, and divorce.

The judiciary in general, and the Administrative Office in particular, will continue to monitor case filings, measure bankruptcy court workloads, and analyze case law developments. The present is a time of great uncertainty, and it is difficult to predict future caseload. The picture, though, should become clearer in 2007, and the Administrative Office will keep the appropriations committees informed as to the Act's impact on court revenues and staffing needs.

IV. SPECIFIC IMPACTS

A. Federal Rules of Procedure and Official Forms

The Act made several substantive and procedural changes in the bankruptcy system that either conflicted with the existing Federal Rules of Bankruptcy Procedure or required new federal rules. In addition, the legislation specifically mandated that the Judicial Conference promulgate certain new rules and forms.[3]

Federal rulemaking under the Rules Enabling Act is a very careful and deliberative process. It includes consideration of proposed rule amendments by blue-ribbon committees of lawyers, judges, and law professors; widespread publication of proposed amendments; consideration of public comments; conduct of public hearings; and approval by the respective rules advisory committees, the Standing Rules Committee of the Judicial Conference, the Conference itself, and the Supreme Court.[4] After the Supreme Court promulgates a rule, it takes effect in seven months unless Congress acts to reject it.

The rules process ordinarily takes about three years to complete, but this major overhaul of the bankruptcy system had to be accomplished in six months. Because the Act took effect 180 days after enactment, the Judicial Conference's Advisory Committee on Bankruptcy Rules met the day after the Act was signed and adopted an expedited program to draft and have in place, by October 17, 2005, uniform interim rules and forms addressing all the matters in the Act that required immediate attention. Adoption of the interim rules and forms was designed to bridge the gap between the Act's effective date and the promulgation of national rules through the regular Rules Enabling Act process.

To accomplish this task, the advisory committee hired two extra law professors and created six subject-matter subcommittees to deal, respectively, with:

- consumer provisions;
- business provisions;
- forms;
- cross-border insolvency;
- attorney conduct and health care; and
- privacy, public access, and appeals.

The full advisory committee and the various subcommittees held a series of meetings and teleconferences, exchanging numerous proposed drafts. In August 2005, the full committee met and approved 40 new or amended bankruptcy rules and made changes to virtually all the official bankruptcy forms. Later in August 2005, the Standing Rules Committee and the Executive Committee of the Judicial Conference approved the forms and interim rules. All the bankruptcy courts then adopted the uniform interim rules as local court rules before the deadline of October 17, 2005.

---

[3] *See, e.g.*, Bankruptcy Abuse Prevention and Consumer Protection Act, §§ 315, 418, 419, 433, 434, 1232.

[4] Under Fed. R. Bankr. P. 9009, the official bankruptcy forms — unlike the rules — are promulgated by the Judicial Conference and do not have to be approved by the Supreme Court.

Using the interim rules as a starting point and adding other provisions to the Act that did not necessitate immediate action before October 17, 2005, the advisory committee at its Fall 2005 and Spring 2006 meetings approved proposed permanent changes to the forms and the Federal Rules of Bankruptcy Procedure. The proposals will be published for public comment in August 2006.

B. National Procedures and Regulations

In addition to promulgating new national rules and forms, the Act required the judiciary to develop new national regulations, procedures, and guidelines. These requirements were addressed in a coordinated effort by several Judicial Conference committees, the Administrative Office, the Federal Judicial Center, standing court advisory groups, and ad hoc working groups of judges, clerks, and other court personnel.

Section 315 of the Act requires debtors to give copies of certain federal tax returns to the bankruptcy court, and it mandates that the Director of the Administrative Office establish procedures for "safeguarding the confidentiality of any tax information required to be provided." The Director's procedures must include restrictions on creditor access to the information. In addition, § 315 requires the Director to report to Congress within 540 days after enactment, assessing the effectiveness of the procedures. In September 2005, the Judicial Conference approved the *Director's Interim Guidance Regarding Tax Information Under 11 U.S.C. § 521*. This guidance protects the confidentiality of tax information by creating a mechanism whereby access to such information is granted only upon motion by an appropriate party and by ensuring that private tax information is not publicly available.

Section 418 of the Act authorizes Chapter 7 debtors to ask the bankruptcy courts to grant them *in forma pauperis* status and waive statutory filing fees and other fees. It also requires the bankruptcy courts to follow procedures prescribed by the Judicial Conference in waiving fees in certain Chapter 7 cases. In August 2005, the Judicial Conference — acting through its Executive Committee with the help of the Administrative Office, the Federal Judicial Center, and two other committees of the Conference — approved interim procedures to govern filing, consideration, and disposition of *in forma pauperis* applications in Chapter 7 cases. The Conference also approved an official application form for requesting *in forma pauperis* status. The Bankruptcy Committee of the Conference is continuing to evaluate the interim procedures and will consider permanent procedures after the courts have had sufficient time to gain experience with them and provide comments on their function and effectiveness.

Section 315 of the Act permits a creditor to file with *any* bankruptcy court a notice of address to be used by *all* bankruptcy courts (or by particular bankruptcy courts) for sending notices to the creditor in Chapter 7 and Chapter 13 cases. The judiciary has used a contractor for several years to distribute paper and electronic notices in bankruptcy cases, realizing great savings for the government and creditors. With the assistance of court personnel and the contractor, the Administrative Office developed an automated interface between CM/ECF, the judiciary's electronic case management system, and the national creditor database to meet all the

Act's noticing requirements. By October 17, 2005, the Act's effective date, the "National Creditor Registration Service" was launched. Creditors can download appropriate preferred address registration forms at the program's website. The new service is expected to provide better service to notice recipients while further reducing the judiciary's postage expenses.

C. New Administrative Procedures in the Courts

Under Section 102 of the Act, the bankruptcy clerk's office, within 10 days of the filing of an individual's Chapter 7 case, must notify all creditors if the financial information filed by the debtor indicates that there is a presumption of abuse under the complex means test set forth in the Act. The presumption of abuse arises, in essence, if calculation of the debtor's current monthly income and expenses from the papers filed with the clerk show that the debtor can repay $100 a month to unsecured creditors over 60 months.[5]

The Administrative Office worked with the courts to develop case-opening procedures to assist courts in complying with the new requirements in this area. For example, elements were included in the judiciary's electronic case filing system to capture the necessary information automatically and generate an appropriate notice to creditors. If debtors fail to submit sufficient information at filing, the court can issue a deficiency notice reminding them of their obligations and setting forth the potential consequences of failing to file all required information, including dismissal of the case.

Under Section 102 of the Act, revised 11 U.S.C. § 704(b), the bankruptcy administrator or U.S. trustee, within 10 days of the first meeting of creditors, must file a statement as to whether a case is presumed to be abusive. Within five days of receiving the statement, the bankruptcy clerk's office must provide a copy of the statement to all creditors. Within 30 days of the meeting the bankruptcy administrator or U.S. trustee must file either: (1) a motion to dismiss the case based on a presumption of abuse if the debtor's current monthly income is above the state's median family income, or (2) a statement as to why the case is not presumed abusive. The Administrative Office worked closely with the Executive Office for U.S. Trustees to develop automated procedures and forms for capturing the information and sending the proper notice.

Section 203(b) of the Act requires each bankruptcy court to "establish procedures for referring any case that may contain a materially fraudulent statement in a bankruptcy schedule" to the U.S. attorney and the local FBI. (The provision is in addition to 18 U.S.C. § 3057, which for many years has required all judges to report potential bankruptcy crimes to the U.S. attorneys.) The Administrative Office advised each court of the new statutory requirement, and encouraged the courts to reduce the procedures to writing, send them to the Administrative Office, and make them available to every judge and court employee.

[5] Once the presumption of abuse is created under the statutory formula, the case is supposed to be dismissed unless the debtor rebuts the presumption with documented special circumstances or expenses or agrees to convert the case to Chapter 13.

To be eligible to file a bankruptcy case under Chapters 7, 11, or 13, individuals are required by Section 106 of the Act to receive an approved credit counseling briefing (which must take place in the 180-day period preceding the date of the filing of the petition). To receive a discharge of their debts under Chapters 7 and 13, individuals are also required by Section 106 of the Act to complete an approved financial management course. Bankruptcy deputy clerks are responsible for following new operational and technological procedures, developed with the Administrative Office, to monitor compliance with these counseling and educational requirements and to take appropriate actions, such as dismissal or closing of cases without discharge, when the requirements are not fulfilled.

Section 311 of the Act added a new exception to current automatic stay provisions regarding leases, which applies to any eviction or similar proceeding against a debtor tenant if the

landlord has obtained a judgment for possession of the leasehold before the date of the filing of the petition. Under this section, the petition must indicate whether a pre-petition judgment for possession has been obtained and whether a right to cure is available under state law. If so indicated, the debtor must deposit with the clerk of the bankruptcy court any rent that would become due during the 30-day period after the filing of the bankruptcy petition, which the court must then transmit to the landlord. This provision required the bankruptcy courts to develop procedures for the receipt, safekeeping, and transmission of these rental funds, and to work with their district courts to create a mechanism for the district courts to remit the funds to the landlord. Due to the potential liability issues involved, it is imperative that courts comply strictly with the procedures adopted.

Among the many other new provisions added by the Act are direct appeals to the circuit courts in certain instances, automatic dismissals for failure to file required documentation, and expanded provisions for reaffirming pre-petition debts. The latter necessitated the bankruptcy courts to adopt new operational and technical procedures, and it significantly increases the resources required to process a typical bankruptcy case.

D. Effect on Judges

Bankruptcy judges have reported varied experience with the Act. During the six-month period between enactment of the legislation and its effective date, all judges had to read, analyze and absorb the changes to the Bankruptcy Code. They also had to work with chambers staff, clerk's office staff, and their local bankruptcy administrator or U.S. trustee to determine how best to implement the Act's provisions in their district. Many judges spent substantial time participating in local and national seminars assisting the bankruptcy bar in understanding the changes made by the Act.

On October 17, 2005, the Act's effective date, bankruptcy judges began simultaneously presiding over two bankruptcy systems — one for pre-Act cases and one for post-Act cases. For several months, the judges were handling the influx of cases filed in advance of the effective date. At the same time, they began applying the new requirements and provisions of the Act to new cases filed. Many cases filed after October 17, 2005, required analysis and interpretation of novel legal issues that the courts had never before considered.

The impact of the Act on judges has varied greatly from district to district. Anecdotally, bankruptcy judges have reported two differing scenarios.

Some bankruptcy judges report that they have been inundated with Act-related work and that each case has taken more time than before the Act. In all, the Act created more than 35 types of new motions, objections, and hearings that did not exist before. These judges report that they have had to analyze each new matter, issue, or question, make a decision, and report it to the bar through written opinions, orders, or instructions.

Other bankruptcy judges, meanwhile, report little impact on their overall workload, largely because of the drop in new case filings occurring after October 17, 2005. They agree that cases generally take more time and that they have had to devote considerable time initially to devising and revising local procedures to implement the Act's provisions. But they say that they have not yet seen many of the new issues, motions, and problems created by the Act. As filings increase, though, they anticipate that these new matters will come before them eventually.

If case filings return to pre-Act levels — as most judges believe they will — the added work required by the Act will result in a heavier overall workload. Judges also anticipate an increase in the number of adversary proceedings as the bar seeks interpretation of the new Act and its effect on bankruptcy issues.

Another factor in the workload of the judges includes the Act's authorization of 28 new judgeships. In the districts that received additional judgeships, the workload of the sitting judges has been alleviated as a natural function of the additional resources. But in the districts that did not receive needed judgeships, the workload of the judges has either remained constant or increased since the Act's effective date.

E. Reprogramming of Electronic Case Files and Case Management Systems

The judiciary's electronic case management and case files system (CM/ECF) had to be modified significantly, in two special CM/ECF software releases, to accommodate all the changes mandated by the Act. Work on identifying the requirements, designing the solutions, and developing the software began even before the legislation was enacted.

The first release was delivered to the courts in September 2005. It included a new starter dictionary, which controls the behavior of the application, to assist the courts with incorporating the new docket events and the changes designed specifically for compliance with the Act. Each bankruptcy court was required to install the new software, configure the application, modify its dictionary, and test and implement the application by October 17, 2005, the Act's effective date. In addition, the Administrative Office has had to migrate all the bankruptcy courts from the aging Solaris platform to the new Linux platform by October 2006 in order to be able to receive the new statistics required by the Act.

In August 2006, the courts will receive a second software release that addresses the collection of statistical data required by the Act. Courts must install the new software, configure the application, and implement by October 17, 2006. Deputy clerks from each bankruptcy court will attend a series of training programs on the new statistical system in August 2006.

F. Collection of New Statistics

Section 601 of the Act requires the bankruptcy clerks to collect, and the Administrative Office to report, new statistics on consumer debtor cases. The new data must be collected starting October 2006, and the Administrative Office must present new reports containing those new data to Congress by October 2007 and annually thereafter. In addition, because of the extensive changes made by the Act, existing statistics already collected by the judiciary have to be modified, and many new statistics will be needed to track the loss of fee income, reflect the new work of the bankruptcy courts, reassess judgeship needs, and revise work measurement and budget allotment formulas. This has required the judiciary to:

- identify the information that must be captured to comply with the new reporting requirements;
- determine how to have the information entered in a uniform manner by all the bankruptcy courts into their CM/ECF electronic databases for eventual extraction and transmission to the Administrative Office; and
- determine how to store, retrieve, analyze, and disseminate these data, using a newly developed statistical infrastructure.

Court forms and reporting schedules, staff procedures for case management, and data quality control have had to undergo extensive revision as a result of changes in the law. *Pro se* filings are likely to become a greater portion of bankruptcy filings, especially since courts have been authorized by the Act to waive filing fees. The *pro se* filings are almost always in paper form, which means that the data entry workloads of court staff are significantly increased. Court staff, moreover, have to make sure that the *pro se* debtors provide all the newly required data elements so they may be entered accurately in the courts' electronic systems.

Electronic filing is strongly urged by most courts, and in some, as many as 90 percent of petitioners file electronically. It is imperative that the software developed by the court and by private vendors deliver complete and accurate data elements that can be used for reporting case information to the Administrative Office. Court and Administrative Office staff working together have devoted significant time to analyzing how to gather the newly required data elements from debtors in ways that encourage compliance by law office software vendors, attorneys, and non-attorney petition preparers. The Administrative Office has provided to vendors of law firm software the information needed to ensure that they upgrade their products to comply with the new bankruptcy law, and it has entered into discussions on how to accomplish that goal with the least burden to the vendors. Administrative Office and court staff are also working together to alert the bar and petition preparers to the need to upgrade their software to comply with the new bankruptcy information requirements.

In addition, local court staff must train the bar and petition preparers in meeting the new legal requirements. Administrative Office personnel have worked with court staff to identify the components of that new training.

Administrative Office staff are also continuing to work with the Executive Office for U.S. Trustees to develop and implement "smart forms" — data-tagged Web forms, schedules, and other documents that will eventually minimize data entry by the trustees and court staff.

A new enterprise database infrastructure and new software tools are required to enable the Administrative Office to collect and compile the new statistics required by the Act. Accordingly, the Administrative Office expedited its plans to build a replacement statistical system for the judiciary so that it could be in place by October 2006 to receive the new bankruptcy data. Several IT staff were detailed to a program to complete the new electronic database by the deadline. Contractors have had to be engaged to the extent that Administrative Office IT staff resources could not meet the demands of these initiatives. The new design is now largely complete for the bankruptcy component of the replacement enterprise database infrastructure, and programming, internal testing and training have begun. By the end of September 2006, external testing and training should be completed.

Because the entire replacement infrastructure is too complicated and extensive to be completed by October 2006, a combination of the completed portions of that system and the pre-existing mainframe-based database (legacy) system will be used in the interim. The new infrastructure will store court transmitted statistics, portions of which will be fed to the Administrative Office's pre-existing bankruptcy databases. The Administrative Office will use the legacy databases to produce the previously established quarterly and annual reports until the new infrastructure's reporting functions can be completed. Designing, developing, and operating this combination system would not be necessary but for the new reporting requirements and the deadlines in the Act.

G. Bankruptcy Administrator Duties

The judiciary administers the Bankruptcy Administrator program in the six judicial districts located in the States of Alabama and North Carolina, parallel to the United States trustee system, which operates in all other districts. The Act imposes substantial new duties upon the bankruptcy administrators.

Section 111 of the Act requires the bankruptcy administrators and U.S. trustees to review annually the applications of and certify consumer credit counselors and debtor financial management education programs. Section 106 states that individual debtors may not file a case unless they have, within 180 days of filing, had a briefing by a nonprofit credit counseling agency approved by the bankruptcy administrator or U.S. trustee. In addition, Chapter 7 and Chapter 13 debtors may not receive a discharge unless they have completed a financial management course approved by the bankruptcy administrator or U.S. trustee.

Bankruptcy administrators are required to review applications from organizations wishing to provide personal financial management instruction courses. In August 2005, the Judicial Conference, acting through its Executive Committee, approved form applications, related appendices, instructions, and standard procedures for the bankruptcy administrators to use in reviewing and approving or rejecting applications.

Section 603 requires the Judicial Conference to "establish procedures in bankruptcy administrator districts to determine the accuracy, veracity, and completeness of petitions, schedules, and other information that the debtor is required to provide." Random audits must be conducted by independent auditors of bankruptcy petitions and schedules in Chapter 7 and Chapter 13 cases to determine their veracity according to generally accepted auditing standards promulgated by the Judicial Conference. The audits are likely to be costly to the judiciary. In addition, the judiciary must report annual information on the results of debtor audits, including the percentage of cases in which material misstatement of income or expenditures is reported.

The Act also requires bankruptcy administrators to develop standards and procedures to implement the new means-testing requirements in their districts and to compile new statistical information on bankruptcy administration in Alabama and North Carolina. The results of a professional work measurement study will determine their actual staffing needs.

Under the guidance of the Bankruptcy Committee of the Judicial Conference, the Administrative Office consulted with the bankruptcy administrators to identify their new responsibilities and develop procedures, policy, and guidelines to implement the Act. Working together, they succeeded in:

- amending the national bankruptcy administrator regulations;
- implementing the means-testing provision of the Act;
- revising internal procedures in bankruptcy administrator offices;
- drafting new operational forms;
- certifying financial management training and credit counseling programs;
- devising procedures for future monitoring of debtor filings;
- selecting a contractor to conduct the new debtor audits required by the Act;
- policing bankruptcy petition preparers and debt relief agencies; and
- providing training on the Act for bankruptcy administrator staff.

In addition, the judiciary has coordinated closely with the U.S. trustee program on implementing these provisions of the Act.

With the help of a contractor, the Administrative Office has developed a new electronic case management system (BACMS) for the bankruptcy administrators that will facilitate their tracking of cases and oversight of financial matters. The system will interface with CM/ECF and incorporate all the new responsibilities assigned to bankruptcy administrators by the Act. The system is currently in final testing and will be deployed shortly.

Because of the numerous changes in substantive law and procedures resulting from the Act, the *Bankruptcy Administration Manual,* prepared by the Administrative Office and approved by the Bankruptcy Committee of the Judicial Conference needs major revision. The Administrative Office has begun work in drafting text addressing the changes made by the Act and their impact on the bankruptcy administrator offices. Staff will start with the early volumes of the manual that delineate the authorities for the program and the responsibilities of the bankruptcy administrators. Several later sections will be assigned to the bankruptcy administrator offices for revision.

H. Training Programs and Publications

The Act made many changes in the Bankruptcy Code that affect the work of every bankruptcy judge, clerk, administrator, trustee, and lawyer. A great deal of training has been required at all levels. A host of new publications was developed by commercial sources and widely purchased by the bankruptcy community. The Federal Judicial Center conducted a number of educational programs for bankruptcy judges, clerks, and administrators, both by satellite television and in classroom settings. The Center's regular workshops for judges and programs for clerks were revised to focus on the Act's provisions and how to implement them.

The Center and the Administrative Office have posted large amounts of materials about the Act on the judiciary's internal website, including rules, forms, Q&As, and suggested procedures. In addition, an organized series of conference calls was held with court employees all around the country on the Act and on practical implementation issues. The Center and the Administrative Office sponsored an operational practice forum for 275 court employees focusing on CM/ECF, the bankruptcy electronic case management and case files system, to address the operational problems and challenges posed by the Act. For employees who could not attend in person, the conference was also made available via Webex. An additional forum was held in July 2006, and another series of large-scale conference calls on Act issues is being scheduled.

Because of the Act's new statistical requirements, a series of eight programs will be held this summer for representatives from every bankruptcy clerk's office to instruct them on how to docket, collect, enter, and transmit the new statistical data to the Administrative Office beginning in October 2006. Further training of clerk's office staff will be required in the future.

In time for the effective date of the Act, October 17, 2005, the Administrative Office rewrote its widely-used publication *Bankruptcy Basics* to incorporate the changes made by the Act. The publication is posted on the judiciary's website and on the websites of many of the bankruptcy courts. It is also distributed at clerk's office counters and is used as a tool for training law clerks, deputy clerks, and other court personnel.

As noted above, work has begun on rewriting the entire *Bankruptcy Administration Manual* used by the bankruptcy administrators. In addition, the manual for bankruptcy clerks will have to be rewritten.

I. Workload Formulas

At the time the Act was enacted, the Federal Judicial Center was in the midst of gathering empirical data on the work of bankruptcy judges and developing a new weighted caseload formula to assist the Judicial Conference in measuring judicial activity and assessing bankruptcy judgeship needs. The Act, however, made so many changes to the Bankruptcy Code and created so many new procedures that the daily work of bankruptcy judges will necessarily change in many respects. Moreover, it will take some time for the courts to implement the various new procedures and to resolve disputes over the meaning of the new law. Therefore, the Center and the Bankruptcy Committee of the Conference decided to suspend further data gathering for the time being. Options are being explored as to when and how to update the study and produce new case weights that take into account the provisions of the new law. It is likely that the work will resume in 2007.

The Act has had a major impact on the work of personnel of the bankruptcy clerks' offices. Accordingly, the work measurement formula used to assess the personnel and budget needs of clerks' offices must be revised. A working group of bankruptcy judges, clerks, and deputy clerks was established to identify changes in clerk's office operations and estimate the time necessary to perform all the new tasks required by the Act for inclusion in a revised workload formula that can be used in FY 2007. After several meetings of the working group and empirical work by the Administrative Office's work measurement staff, the working group met together with the Administrative Office's advisory group of bankruptcy clerks to identify appropriate revisions to the workload measurement formulas. The empirical studies show that the work of the bankruptcy clerks' office has increased by 10 percent as a direct result of the Act.

Work will also begin on developing a work measurement formula for bankruptcy administrator offices. The Act's provisions dealing with means-testing, oversight of credit counseling and financial management providers, financial audits of debtors, and bankruptcy administrator reporting requirements will be determined by the work measurement effort.

J. Filing Fee Revenues

Effective October 17, 2005, filing fees for Chapter 7 cases were increased to $220, Chapter 11 fees were increased to $1,000, and Chapter 13 fees were reduced to $150. After enactment of the Act, bankruptcy fees were again raised by Congress in the Deficit Reduction Act of 2005. As of April 9, 2006, the filing fee for a Chapter 7 case became $245, and the fee for filing a Chapter 13 case became $235.

The Act authorizes individual Chapter 7 debtors to seek approval from the court to file their cases *in forma pauperis* (i.e., without paying a filing fee) if their income is less than 150 percent of the official poverty line. If the filing fee is waived, the judiciary — along with the U.S. trustee system, the individual trustee in the case, and the Treasury — does not receive the fee revenue associated with the filing. Initial statistics from the courts indicate that waivers of filing fees are being granted in approximately 2 percent of Chapter 7 cases. At this point, it is too early to predict whether the percentage of fee waivers will remain at this level. But if that occurs and filings return to their pre-Act level, the projected loss of annual revenue to the judiciary from the *in forma pauperis* provision of the Act could be significant.

K. Additional Judgeships

Bankruptcy judgeships are established by Congress upon the recommendation of the Judicial Conference, and bankruptcy judges are appointed to the judgeships by the respective courts of appeals for the circuits.[6] Based on substantial increases in bankruptcy filings, the Judicial Conference had recommended that Congress authorize an additional 47 bankruptcy judges, the first new judgeships to be authorized since 1991. The Act, however, established only 28 judgeships, including five not sought by the Conference.

In accordance with 28 U.S.C. § 152(b)(1), the Judicial Conference determined the official duty stations of the new judgeships authorized by the Act, after considering the recommendations of the Administrative Office and the judicial councils of the circuits. The courts of appeals proceeded to advertise the positions, appoint selection committees, and make the appointments of the new bankruptcy judges. Chambers and courtrooms had to be established, with construction costs varying from minor to major. The additional costs had to be identified, including estimated construction, annual rent, LAN installation, courtroom technology, and miscellaneous force-move costs. In addition, chambers staff had to be hired, books and equipment obtained, and judges and staff trained.

The judiciary is pursuing the additional 24 requested judges that Congress did not provide and conversion of some of the newly authorized judgeships from temporary to permanent status.

CONCLUSION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was a 500-plus-page piece of legislation that made major changes in the substantive law of bankruptcy and materially affected bankruptcy practice. The judiciary has undertaken extensive efforts to implement the Act, at both the national level and locally in each court. In the 15 months that have elapsed since the Act was signed into law, the judiciary, among other things, has:

---

[6] 28 U.S.C. § 152.

- issued interim procedural rules for the bench and bar to implement the Act in the bankruptcy courts;
- revised most of the official bankruptcy forms that must be used in bankruptcy cases;
- proposed major, permanent changes to the Federal Rules of Bankruptcy Procedure that will be published shortly for public comment;
- issued national regulations to implement several of the Act's new statutory provisions;
- developed new administrative procedures for the bankruptcy courts;
- developed an automated interface between its electronic case management system and its electronic noticing system that will allow creditors to file preferred addresses with any bankruptcy court and have them used by all bankruptcy courts;
- reprogrammed the judiciary's electronic case filing and case management systems;
- designed and programmed systems to gather and compile the new statistics required by the Act;
- built a replacement electronic system capable of processing the new statistics;
- identified and expanded the duties and responsibilities of bankruptcy administrators;
- presented many new training programs for judges and court staff;
- begun rewriting its bankruptcy manuals and other bankruptcy publications; and
- begun revising the work measurement formulas used to allocate supporting personnel and other resources in the courts.

Locally, the Act had a substantial impact on each bankruptcy court, as case filings spiked just before the Act's effective date. The filings declined substantially after that, but they are rising again. Each bankruptcy court has had to adapt to all the statutory changes, to the new rules and forms, to the new regulations and procedures, and to the major changes in its software systems. Judges had to interpret the new law on a case-by-case basis, and the courts of appeals are beginning to hear appeals from the decisions of the lower courts. Training efforts directed at bankruptcy judges, clerks, and administrators have been substantial and ongoing.

Professional empirical work measurement studies are also continuing. The first study to be completed, that of the bankruptcy clerks' offices, has shown that the staffing requirements in the clerks' offices have increased by 10 percent as a result of the Act. A work measurement study of the bankruptcy administrators' offices will begin soon, and the work measurement study of bankruptcy judges — which had been in process when the Act was enacted — will likely resume in 2007.

Every bankruptcy court, as well as the judiciary as an institution, accomplished a great deal over the past 15 months. All the statutory deadlines were met, and all the necessary changes in practice and procedure required by the new legislation were made. Looking to the future, the workload of the courts will increase in each bankruptcy case — particularly the workload of bankruptcy clerks and administrators. But the overall workload of the bankruptcy courts will depend on the level of case filings, a number that remains uncertain at this point.

Bankruptcy Reform: What Has It Meant?
By Steven Sloan
17 October 2006
American Banker

WASHINGTON -- A year after major changes to the Bankruptcy Code took effect, bankers and outside experts are continuing to debate whether the reforms did financial institutions any good.

Several industry representatives argue that a sharp decline in overall filings for bankruptcy protection this year, and preliminary data indicating that chargeoffs are falling, prove that the reform law that went into effect Oct. 17, 2005, was worth it.

Banks are "better off, because fewer customers are entering bankruptcy and fewer loans are being written off," said Wayne Abernathy, the executive director of financial institutions policy at the American Bankers Association.

But others say that it is too early to tell, and that critical figures, such as the rate of delinquencies and recoveries from debtors, are not yet in. Some also argue that stories of abuse in the bankruptcy system were overdramatized, and that the reform law has not made more debtors able to repay their loans.

A provision requiring well-heeled debtors to repay some of their debt "hasn't worked, ... because there weren't many people who could pay their debts in the first place," said Henry Sommer, the president of the National Association of Consumer Bankruptcy Attorneys.

The Bankruptcy Abuse Prevention and Consumer Protection Act instituted several changes to the system, including increased filing fees, mandatory credit counseling, and a requirement that debtors with substantial income pay at least some of their debt.

Available data on the law's effect is incomplete, but it is clear that filings have declined dramatically in the past year. As of Oct. 8 the number of petitions for bankruptcy protection filed this year was 79.7% less than the number filed last year, according to Lundquist Consulting Inc., a California company that compiles bankruptcy data.

However, the 2005 total of nearly 2.1 million was abnormally high and included 600,000 Chapter 7 petitions filed during the two weeks before the law was enacted.

There are also indications that the number of filings is beginning to rebound. The number of petitions filed during the week that ended Oct. 8 nearly tripled from the number filed during the week that ended Jan. 8, according to Lundquist Consulting's data.

Though Mr. Abernathy argued that the drop in filings alone proves that the changes worked, others say it misses the point.

"The question about the bankruptcy law in the first place was not whether filings would decline," said Stuart Feldstein, the president and co-founder of SMR Research. "The question was whether that would be made up for by an increase in nonbankruptcy chargeoffs."

Preliminary data indicates that bankers, especially credit card issuers, have enjoyed lower chargeoff rates as bankruptcy filings have dropped off. But analysts said they expect chargeoffs to begin increasing as delinquency rates and bankruptcy petitions slowly rise.

Even staunch supporters of the reforms question whether the drop in filings translates into financial gains for banks.

"A lot depends on how much shows up in other delinquency areas," said Jeff Tassey, the principal of the lobbying firm Tassey & Associates, who was a key figure in helping to pass the reform law. "A decline in filings is a good thing. How much of it shows up on the other side is unknown."

Critics also question whether the law, which was one of the industry's top political goals, has done anything to alter the underlying causes of bankruptcy.

"The laws changed, but people went into bankruptcy because of job loss or divorce, and those problems haven't gone away," said Nina Parker, a longtime consumer bankruptcy lawyer in Winchester, Mass. "They've made the requirements more difficult, but they didn't fix the problem."

Sam Gerdano, the executive director of the American Bankruptcy Institute, said he senses disappointment about the changes, which he attributes to big promises from lawmakers that could never be kept.

"The bill, at its worst, was oversold as some magic pill that would return untold dollars in the pockets of creditors," he said. "But those dollars aren't there, because as an economic matter, [debtors are] too far gone."

One benefit that Mr. Gerdano said was oversold was the elimination of fraudulent bankruptcies and "bankruptcies of convenience." He estimates that only 2% to 3% of consumer bankruptcy filings were fraudulent before the legislation was enacted. "In 98 out of 100 cases, there's nothing there."

Still, supporters of the law insist that banks are better positioned, because they do not have to worry about questionable bankruptcies.

"Now they have a system they know is much more fair and honest," Mr. Tassey said.

Another area of contention remains a provision that requires potential debtors to seek credit counseling before filing for protection from creditors. The idea was that the counseling could provide alternatives for consumers who could work out individual agreements with creditors while ensuring that the truly destitute could still seek court protection.

But critics have charged that credit counseling has failed because consumers seeking protection have such high levels of debt that they have no other options, essentially making the provision another hurdle to jump before filing.

For example, the National Foundation for Credit Counseling released data Monday showing that virtually every consumer who sought counseling through one if the group's 115 members proceeded with a bankruptcy filing.

But bankers defend counseling as a way to ensure that the doors to bankruptcy courts remain open for consumers in dire shape.

"The intent of the law was not for the certified credit counselors to prevent consumers from filing bankruptcy but to ensure that bankruptcy is a last result," said Steve Bartlett, the president and chief executive of the **Financial Services Roundtable**.

While both sides debate the law's impact, an emerging concern is whether it will remain intact if Democrats gain a majority in the House or Senate. Mr. Gerdano said that the counseling provision and higher filing fees would be prime targets. "I would expect it to be revisited. I would be shocked if ... [Democrats] didn't reopen at least part of it," he said.

AMERICAN BANKRUPTCY INSTITUTE

December 8, 2006

Hon. Jeff Sessions
Chairman
Senate Judiciary Committee
Subcommittee on Administrative Oversight
and the Courts
Washington, D.C. 20510

RE: December 6, 2006 Hearing on BAPCPA

Dear Mr. Chairman:

Attached please find excerpts from the Transcript of Proceedings from the American Bankruptcy Institute's "A Year After BAPCPA" program, held October 16, 2006 at Georgetown University Law Center. This program, supported with the financial help of the Financial Services Roundtable, featured a balanced mix of practitioners, judges, government regulators and academics. The program covered the one year experience, post BAPCPA, in both consumer and commercial bankruptcy. The program featured both creditor and debtor interests, covering issues from credit counseling to means testing and the effects on commercial cases, among other issues.

As you know, the American Bankruptcy Institute does not take advocacy positions before Congress, but is rather a neutral source for information on developments in bankruptcy law. We hope these excerpts can be included in the official record of the December 6 proceedings as ABI's contribution to a fuller record. Please let us know how we can further assist the committee's work.

Sincerely,

Samuel J. Gerdano
Executive Director

44 Canal Center Plaza, Suite 404 • Alexandria, VA 22314-1592 • 703.739.0800 • Fax: 703.739.1060
www.abiworld.org • info@abiworld.org

American Bankruptcy Institute • 1982 • 2007 • 25th Anniversary

A Year After BAPCPA

How the Bankruptcy Abuse Prevention and Consumer Protection Act Has Impacted Bankruptcy Practitioners, Lenders, Consumers, Turnaround Managers and Trustees

October 16, 2006
Georgetown University Law Center
Washington, D.C.

Transcript of Proceedings - Excerpts

Table of Contents

Macro Overview of the Effects of BAPCPA

*Melyssa Barrett – Moderator**
Visa USA, Inc.; San Francisco

Dr. Teresa A. Sullivan
Provost, University of Michigan; Ann Arbor, Mich.

Clifford White
Acting Director, EOUST; Washington, D.C.

Prof. Michelle J. White
University of California; San Diego

Credit Counseling

*Travis Plunkett – Moderator**
Consumer Federation of America; Washington, D.C.

Ivan Hand
CEO, Money Management International; Houston

Henry G. Hobbs
Acting Chief, Debtor Education and Credit Counseling Section,
EOUST; Washington, D.C.

Susan C. Keating
President and CEO, National Foundation for Credit Counseling,
Silver Spring, Md.

John Rao
National Consumer Law Center; Boston

Business Bankruptcy: How Has BAPCPA Affected Chapter 11 Filings?

*Richardo I. Kilpatrick – Moderator**
Kilpatrick & Associates, PC; Auburn Hills, Mich.

Lisa J. Donahue
AlixPartners LLC; New York

Susan M. Freeman
Lewis and Roca LLP; Phoenix

Stuart A. Gold
Gold, Lange & Majoros, PC; Southfield, Mich.

Hon. Elizabeth L. Perris
U.S. Bankruptcy Judge (D. Ore.); Portland, Ore.

Chapter 7 & 13 Issues: Means Testing and Good Faith

*Lawrence A. Friedman – Moderator**
eCAST Settlement Group; New York

Andrea E. Celli
Chapter 13 Trustee; Albany, N.Y.

Mark A. Redmiles
Chief, Civil Enforcement Unit, EOUST; Washington, D.C.

Prof. Michaela M. White
Creighton University School of Law; Omaha, Neb.

How Has BAPCPA Impacted Debtor's Attorneys?

*Lynn L. Tavenner – Moderator**
Tavenner & Beran PLC; Richmond, Va.

Norma Hammes
Gold & Hammes; San Jose, Calif.

Henry J. Sommer
Consumer Bankruptcy Assistance Project; Philadelphia

Donald F. Walton
Acting Deputy Director, EOUST; Washington, D.C.

Wrap-Up: What's Next?

*Hon. Dennis R. Dow – Moderator**
U.S. Bankruptcy Judge (W.D. Mo.); Kansas City, Mo.

Hon. Christopher Klein
U.S. Bankruptcy Judge (E.D. Calif.); Sacramento, Calif.

Hon. Eugene Wedoff
Chief U.S. Bankruptcy Judge (N.D. Ill.); Chicago

*Program Steering Committee Member.
Other members: Suzanne Boas (CCCS of Greater Atlanta), Prof. Jean Braucher (Univ. of Ariz.), Roberta DeAngelis (EOUST), John McMickle (Winston & Strawn), Jennifer Smith (Financial Services Roundtable).

Samuel J. Gerdano
American Bankruptcy Institute

ABI is a nonprofit, nonpartisan professional association of more than 11,000 members involved in the bankruptcy process - lawyers, accountants, financial and restructuring professionals, judges, academics, lenders, and others in the insolvency community. We are not an advocacy group and represent neither creditors nor debtors, but rather provide a forum for the exchange of ideas on both legislative policy and issues facing the courts.

Today's program is the product of a steering committee selected to ensure that all points of view on some controversial issues are heard. The committee was chaired by bankruptcy judge Dennis Dow and Professor Jean Braucher of the University of Arizona College of Law.

Our goal is to produce a comprehensive record for Congress on the first-year experience covering both consumer and business bankruptcy developments. We thank in advance our many presenters for their commitment to this goal. We also thank our host, Georgetown University Law Center, and our financial sponsors - the Financial Services Roundtable, the Law Firm of Baker & Hostetler, and the National Data Center for their very important support. We welcome many members of the press. Our speakers know that their comments are on the record. A full transcript of the proceeding is available on the ABI web site, www.abiworld.org.

Macro Overview of the Effects of BAPCPA

Clifford White
Acting Director, EOUST
Washington, D.C.

My general conclusions are that the consumer provisions of the reform law are workable. An initial result shows promise for making long-lasting improvements in the bankruptcy system. Now these accomplishments are due to the good faith and incredibly hard work of dedicated professionals in the U.S. Trustee Program and in the larger bankruptcy community including the judges and so many others who are in the audience today. But I believe we can make faster progress down the road, however, if the tenor of debate can be elevated a bit and if bankruptcy professionals make a greater effort to breed respect for the rule of law.

It is too early to tell the long-term impact of means testing on the bankruptcy system, but let me suggest two preliminary conclusions. First, means testing is workable. There is a system in place by which debtors are able to transport the necessary IRS and Census Bureau information and make required calculations.

Now I need to add a couple of important caveats to that optimistic assessment though. For example, many debtors and their lawyers still do not fill out the means testing form properly. The calculations are not always reliable, and that puts a significant burden on the U.S. Trustee and the private trustees and the courts, but the anecdotal evidence suggests that the quality of the file forms is improving but debtor's counsel still are somewhere on the learning curve.

Now my second preliminary conclusion is, that early data suggest means testing does in fact institutionally for the system, provide a promising approach, or at least early indications are that it provides a promising approach. Of the individual debtors who filed from October 17 through the end of June, 94 percent were below the median income level. Those above the median income level, the U.S. Trustees determined that slightly less than 10 percent were presumed abusive. And of the presumed abusive cases that did not voluntarily convert or dismiss, the U.S. Trustee filed motions to dismiss in about three-quarters of those cases, and declined to file in about one-quarter of the cases.

So to us, these data suggest that means testing is a useful screening device to identify abusive cases. They also suggest that the statute provides the U.S. Trustee with sufficient discretion so that decisions on filing motions to dismiss can be made on a case-by-case basis and not solely based upon a statutory formula. Our first priority was to develop a system to screen out those who might seek to defraud debtors, and importantly it appears that we have been successful so far.

It is almost inevitable that eventually a bad actor may get through the screening system but we are much relieved that the initial efforts appear to have been effective. Beginning in September to further strengthen our efforts, we commenced a series of post-approval on-site reviews of credit counseling and debtor education providers to better verify the applicant's qualifications.

Another important positive sign that credit counseling and debtor education can work is that there is, to date, adequate capacity to serve the debtor population. Again, of course, the true test is going to come when filings reach higher levels in the future.

Prof. Michelle J. White

University of San Diego

Let me turn to thinking about the relationship between bankruptcy and credit card lenders. There has been a trend in credit card pricing toward lower upfront fees and higher penalty fees. We have all received lots of credit card solicitations that offer a zero introductory interest rate, lots of rewards for charging more on your credit card, and zero annual fees. Low upfront fees mean that credit card lenders lose money when people open new accounts. They make up for their losses on new accounts by charging borrowers more when they start to look more risky when they only pay the minimum each month and when they pay late.

These late charges, over-limit charges, and penalty interest rates have been going up. What this pricing pattern does is to encourage people to accept more credit cards and to charge more. Total U.S. credit card debt has been going up at a very rapid rate. It heavily penalizes debtors who fall behind, pay late, or only pay the minimum each month. For these debtors, interest rates quickly go up to 24 percent and 30 percent. This pricing patter increases the riskiness of debtors' consumption, since if something bad happens and debtors fall behind on their payments or make only the minimum payment, they get hit with these very high charges.

The result is that when debtors' earnings are high, their borrowing costs are low, so consumption is high. But when earnings fall, borrowing costs rise steeply and consumption falls. The credit card pricing patter makes consumption more risky, which makes bankruptcy more valuable. But, the adoption of BAPCPA has made it more difficult for debtors to file for bankruptcy. That means that many debtors will delay filing, which means they are more likely to have their wages garnished, and they will pay the high credit card fees for longer. So the social cost of debt is likely to rise.

Dr. Teresa A. Sullivan

Provost, University of Michigan
Ann Arbor, Mich.

What kind of data would it have taken if Congress had wanted to really evaluate whether the law was successful or not? Most importantly, I think we need more data about the debtors who enter bankruptcy, and it is possible that eventually we will have data from the official form that will be more useful. It would also be useful to do a retrospective analysis of those who file for bankruptcy before the new law took effect and to see if those people had, for example, greater income going into bankruptcy than those who went in after the law.

Some earlier studies, including studies based on my own research and that by Michaela White suggest that debtors filing for bankruptcy were already, for the most part, below the median income and that the number of bankruptcies that were presumptively abusive were always low. In that respect, the law did not make very much difference. It would also be useful for us to have some way to see a long range estimate of whether debtor education makes a difference. The debtor audits themselves may form another basis of information for us to get an idea about whether the quality of the data coming into the bankruptcy system has improved.

Finally, I think that to fully study whether or not the law succeeded, more systematic data available on the credit industry, the creditors' attorneys, the consumer debtor attorneys, and on the credit counseling agencies themselves, would be helpful.

Credit Counseling

Susan C. Keating

President and CEO, National Foundation for Credit Counseling
Silver Spring, Md.

After a year's experience, the National Foundation for Credit Counseling believes that we are meeting the mandate of the counseling and the education provisions of the new law. We also believe, however, that it is too early to really understand the ultimate impact to consumers' longer term. However, we do believe that things are going relatively well at this point.

We are finding that consumers are very upside-down financially, and in fact, their unsecured debt exceeds their annual income, and in fact six-month period to now, that delta between the two has grown significantly which is suggesting that the client credit profile is deteriorating.

The number one reason that the agencies are reporting that clients are considering filing for bankruptcy is the fact that they have been overspending, and that there in fact are poor money-management skills or habits and problems. That is coupled with medical problems and also loss of income.

John Rao

National Consumer Law Center
Boston

Having someone go to counseling at a point where they have made a decision or they are considering filing bankruptcy is just too late. If this requirement or the counseling or education component of it were to be effective, you need to start much sooner. In fact, the mandate really should be for some kind of financial education courses in high schools, before students graduate from high school; that would clearly be a much more effective way to help consumers avoid bankruptcy.

The other issue is that for someone who is considering bankruptcy, they need something more than the traditional DMP model that is there now. There are no significant meaningful concessions that are being offered as part of these plans. What the consumer needs is some debt principal reduction.

The third issue is that until there is some really effective regulation of some of the more significant or severe predatory lending practices, consumers are still going to be in this position of facing a debt load that is just too hard for them to deal with.

There should also be an expedited procedure or briefing requirement for debtors whose income is so low that they cannot even meet the basic necessities. And again, the counseling requirement, the education part of it can still be there but that would be dealt with later after the filing, in that debtors who are having problems in Chapter 7's with things like foreclosures would also be eligible for this expedited briefing.

Ivan Hand
CEO, Money Management International
Houston

We surveyed 6,000 counseled clients recently and there was significant knowledge gain relative to some very basic financial concepts, like goal-setting, secured versus unsecured debt, fixed and variable expenses, things that these people did not know before they walked in the door. For the first time, they have now gone through their budget and their finances, and their expenses, so the knowledge gained there is very important.

The other thing that they reported, in the survey, is they have a high likelihood of changing their behavior in the future. They agreed to track income and expenses, reduce spending, cutting unnecessary expenses. There are not as many going into alternative options like debt management plans, but I think that is in large degree due to the timing of when they come to see us. Ninety-two percent of all of the debtors that see us have already retained an attorney. They have already paid fees. Seventy-eight percent of them have paid the vast majority of the fees; almost half of them have paid all of their fees. Once the debtor has paid the attorney's fees, they are so far into the process that it is really hard for them to evaluate any other options.

I mentioned early on that we had surveyed some 6,000 debtors that had gone through both our initial counseling session. We surveyed them pre- and post-counseling and 98 percent of them said that if they ever got in financial trouble again, they would seek credit counseling first. That seems to tell me that they must see some value in it.

Business Bankruptcy: How Has BAPCPA Affected Chapter 11 Filings

Hon. Dennis Dow
U.S. Bankruptcy Judge (W.D. Mo.)
Kansas City, Mo.

One question is whether the passing of BAPCPA has attributed to the decrease in business bankruptcy filings and whether this trend is likely to continue. Of particular relevance are the perceptions that BAPCPA may have increased the cost of Chapter 11 reorganizations. Several changes may have had this effect, including changes which increase cash requirements for debtors, like the treatment of utilities and new administrative priorities for suppliers of goods to the debtor.

Lisa Donahue
AlixPartners LLC
New York

More cash is needed upfront than before so sizing the DIP appropriately is important. Also where there are multiple locations, such as retail, anything that has a branch network where you are limited by the time period on rejecting real property leases to the 18-month exclusivity limitation. You are looking at trying to file more strategically than ever before because you do have a hard stop from an exclusivity perspective.

Stuart Gold
Gold, Lange & Majoros, PC
Southfield, Mich.

The U.S. Trustee has more obligations for the small business debtor to oversee the operations of that small business debtor. It is more important than ever for that small business debtor to have an exit strategy, even more so than even in the larger corporate cases because we have to get in and out relatively quicker than we used to in the past, and given the oversight that is going to be coming in, you better have a good plan to get out before you even enter into the arena.

Richardo Kilpatrick
Kilpatrick & Associates, PC
Auburn Hills, Mich.

The new provisions under 1112 give us the ability to file the motions to convert or dismiss relatively quickly. And it also admonishes the court to do certain things, if we are able to prove of certain facts, such as, that the principals are dishonest or not trustworthy or they are not operating the business in the best interest of the creditors in the estate, and there is a non-exclusive list under 1112 that if the court finds cause, it is really required to either dismiss or convert the case or appoint a trustee or examiner.

So we have new weapons in our arsenal which we will probably be using in the small business case. The leverage in the big cases I think is going to remain the same. The biggest difference is going to be the capital requirements going in.

Lisa Donahue
AlixPartners LLC
New York

KERPS, prior to the change, were routinely approved based really on the business judgment of the debtors and there was a prevailing theory, which, I think, happened to be true, that it is harder to retain employees when you are a debtor-in-possession versus when you are even a distressed company, because once you file bankruptcy, people tend to just head out the door. And it was also based on the premise that the debtor was making sound business judgments and was really trying to work in the best interest of the estate.

Some of the critics of the KERPS felt that it was very top-heavy, it rewarded some of the very people that may have gotten the business into the problems, it was too generous, and basically paid people to stay, without real performance or milestones.

Susan Freeman
Lewis and Roca LLP
Phoenix

The real lessons to be learned from Calpine and Dana are to generate your creditors' support [for KERPs] by showing them how you're structuring this in a way that does benefit the creditors, the overall estate, and really have the evidentiary support for what you are doing.

You could certainly generate the market studies in advance to show you how the wage system, the salary system for this particular company matches up to the industry, and you can start generating your creditors' support by talking with your informal body of creditors to the extent that you have an informal committee. Certainly, talk to your secured creditors, try to start generating that creditor support, and then as soon as you have the creditor group post-bankruptcy, you need to start communicating with them.

Hon. Elizabeth Perris
U.S. Bankruptcy Judge (D. Ore.)
Portland, Ore.

At a practical level the end of exclusivity gives the creditors a right to file their own plan and how valuable that right is going to vary a lot depending on the case. Most commonly in the smaller to midsize cases they are just liquidating plans, and whether that makes sense for the creditors really depends on whether this entity is more valuable to the creditors or at least as valuable on a liquidating basis as it is on an operating basis. Often the rub of the benefits of the end of exclusivity is there is little or nothing for the unsecured creditors and it is only the secured creditor who is going to benefit. In the larger cases, it certainly gets far more complicated than that.

Susan Freeman

Lewis and Roca LLP
Phoenix

Since the addition of 1102(b)(3), the committee must provide access to information to creditors who are not on the committee but who hold the same kind of claims as those on that committee - unsecured or equity - and then solicit and receive comments from them, and be subject to any court order that is requiring them to do something more. The committee members and committee counsel have fiduciary duties to make sure that exactly that happens, and there certainly has been a perception of problems in that regard.

The other thing that is important for the committee counsel to be taking into account is that they really have an obligation to make sure that all of the committee members' views are taken into account. But in doing so, you the committee counsel and the committee members have to take into account the need to protect this confidential information that you are getting from the debtor.

If the debtor gives confidential information about business plans, how it is going to restructure, anything about trade secrets -- if any of that leaks out to competitors, then that is going to harm the debtor. That is going to harm the debtor's business; it is not in the interest of the plan of reorganization. So the creditor body should be concerned about that, and the committee and the committee counsel have obligations to ensure that that just does not happen.

So what do you do in terms of complying with the statute and yet complying with your fiduciary duties and your duties to maximize the distribution to creditors by not harming the debtor in its operations? We have one opinion; that is the Refco opinion, and it is from Judge Drain, and it approves a protocol that is very helpful.

It authorizes the committee expressly to withhold this proprietary information, the confidential information. It expressly authorizes withholding privileged information and withholding information that would be - where any disclosure could be contrary to law -- such as trading information. It authorizes you to take into account whether there are confidentiality agreements in what you send out, so that even with this protocol, it is saying if you want to give information to a particular constituent that is coming in and asking for something, then you can say, "Give me a confidentiality agreement. Give me a trading agreement."

It provides for a committee website as the means for giving information on a regular basis to the committee constituents and getting the information from them with e-mail addresses and supports that method.

And, importantly, for committee counsel and committee members, the Refco order exculpates them from any liability to the extent that they share information and that information does end up being abused.

Chapter 7 and 13 Issues: Means Testing and Good Faith

Hon. Dennis Dow
U.S. Bankruptcy Judge (W.D. Mo.)
Kansas City, Mo.

A centerpiece of BAPCPA, and one of the most widely discussed provisions is the means test designed to channel debtors with ability to pay in their Chapter 13. It authorizes the court to dismiss a case if the debtors' net disposable income exceeds specified levels. The presumption in favor of relief which used to exist has been removed. Income is measured by an average of the debtors' pre-petition income in the six-month period prior to filing. Expenses are measured by a combination of objective limits establishing IRS standard and the debtors' actual expenses in certain categories, with the safe harbor for those below the applicable state median income preliminary data suggests that only a small percentage of debtors are subject to the means test.

There have been relatively few cases interpreting the provisions. Issues in the cases that have been litigated include the ability of the courts to consider ability to pay when ruling on motions to dismiss for bad faith, or on totality of circumstances when a debtor passes or is not subject to the means test, and the availability of certain deductions for debt payments or allowances in situations in which the debtor has no debt payments or intends to surrender a collateral. The importation of these concepts in Chapter 13 has raised interpretive difficulties as the courts struggle to decide whether projected disposal income is a historical construct based on a six-month pre-petition average, as reflected on forms B22C, or is a forward looking concept measured by the debtors' schedules I and J.

Mark A Redmiles
Chief, Civil Enforcement Unit, EOUST
Washington, D.C.

With regard to the debtor's ability to repay under the totality of the circumstances, what the statute says is if the presumption is either rebutted or it does not arise under (b)(2), then the court shall consider the case under (b)(3), consider bad faith, consider totality of the circumstances. What we are talking about here is if there is no presumption, the ability to pay is not apparent when you apply the means test under 707(b)(2). Can the U.S. Trustee and the court analyze the same case under a totality of the circumstances, as opposed to some of the standards or some of the other information that was used in the calculations under the means test?

Judge Wedoff's *Law Review* article extracted in the *ABI Journal* and concludes that the court does have discretion under 707(b)(3) to take a look at the debtor's actual circumstances. So under the means test, if the debtor has two luxury vehicles, two boats, owns a house and has a couple of vacation residences, all of the debt, if it is all secured, all of that debt is an allowed expense under the means test. Well, the question is under 707(b)(3), under totality of the circumstances, should the US Trustee have the ability to bring a motion to say, "That is abusive. This debtor should not be keeping all of that property and should not be paying for that debt at the expense of their creditors," and then should the court have the discretion, the ability to dismiss that motion based upon those facts?

Prof. Michaela M. White
Creighton University School of Law
Omaha, Neb.

I suspect that courts will be looking at the debtor's lifestyle in the same way the courts did pre-BAPCPA. This introduces the issue of whether or not luxury goods, as Mark has characterized them, ought to be retained even if the Schedule of Intention suggests the debtor wishes to retain them. This seems to be the trend in reported cases.

The emerging majority seems to be that projected disposable income for above-median Chapter 13 debtors is a moving target. These cases indicate that projected disposable income ought to be calculated based on the situation at the time of the objection to confirmation, plan confirmation, or modification of the plan.

How Has BAPCPA Impacted Debtor's Attorneys?

Hon. Dennis Dow
U.S. Bankruptcy Judge (W.D. Mo.)
Kansas City, Mo.

Among the most significant changes that were effected by BAPCPA are new duties for, liabilities of, and restrictions on, debtors' counsel. Debt relief agencies, a newly-defined term, are, under certain circumstances subject to sanctions for inaccuracies in the schedules and for cases filed, determined to constitute an abuse. New restrictions are placed on advertising materials and new client disclosures are required. Certain kinds of legal advice are now prohibited and may not be made by debtor's counsel. Constitutional challenges, some of which have been successful, at least in part, have been made to some of these new provisions of the act. To what extent have these provisions affected the attorney-client relationship?

Donald F. Walton

Acting Deputy Director, EOUST
Washington, D.C.

Probably, the Debt Relief Agency has been the area where we have seen the most litigation, the most activity; and the U.S. Trustee Program, the Department of Justice, is either actively now defending, or we have concluded about 15 cases on debt relief agency. Now, unfortunately, all of them which have been concluded have been concluded on procedural grounds strictly. So we do not really have any final rulings substantively on many aspects of debt relief agency, in particular, whether an attorney is a debt relief agency. But one aspect of it that we are comfortable with is that pro bono attorneys are not debt relief agencies.

Under the statute, in order to be a debt relief agency, you must have accepted money or other valuable consideration. We believe that the pro bono programs that are operated throughout the country by bar associations and other outfits, there is no money paid. We will not bring any actions against any attorneys who are operating pro bono. We would encourage, and we continue to encourage, all attorneys to participate in those activities because they are good activities and they have helped the system significantly.

Henry J. Sommer

Miller, Frank & Miller
Philadelphia

I have to say that a lot of the problems, I think, that debtor's attorneys and debtors are facing are because the United States Trustee Program is engaging in "gotcha" motions and they really have taken it upon themselves to act as an arm of the consumer credit industry, with a mission to keep people out of bankruptcy court.

We had a case in Pennsylvania where the debtor was about ten years old, and, I guess, had title to properties. The child filed a Chapter 13 case, and the Chapter 13 trustee came in, I'm sure doing what he thought was US Trustees' bidding, argued that the 10-year-old debtor had to go to credit counseling.

U.S. Trustees have filed motions where some have gotten credit counseling a little bit outside the 180 days. And in other cases trustees, again, saying they are trying to do what the US Trustee asked them to do, have moved to dismiss cases because tax transcripts were filed a couple of days late.

The bankruptcy system ought to be something that is doing justice. If there is a mistake that does not make any difference to the outcome, why in the world are we paying government agencies to spend all this time trying to get people out of the system? And this is causing debtor's attorneys, also, to look over their shoulders, to be afraid of these "gotcha's," of the nitpicking.

We had a case in our pro bono program where the debtor is probably one-quarter of the median income, at best; and someone from the U.S. Trustee's Office calls up and says, "We do not think you filled out the means test form correctly." No matter how you filled out the means test form, this debtor was not going to even be close.

Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION
Governmental Affairs Office
740 Fifteenth Street, NW
Washington, DC 20005-1022
(202) 662-1760
FAX (202) 662-1762

December 6, 2006

The Honorable Jeff Sessions Chairman Subcommittee on Administrative Oversight and the Courts Committee on the Judiciary United States Senate Washington, D.C. 20510	The Honorable Charles E. Schumer Ranking Member Subcommittee on Administrative Oversight and the Courts Committee on the Judiciary United States Senate Washington, D.C. 20510

Re: Oversight Hearing on the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (P.L. 109-8), Scheduled for December 6, 2006

Dear Chairman Sessions and Ranking Member Schumer:

On behalf of the American Bar Association ("ABA") and its more than 410,000 members, I write to express our views concerning the subject of your Subcommittee's oversight hearing on the "Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (P.L. 109-8)." We ask that this letter be included in the official record of today's hearing.

Although the ABA supports several narrow provisions in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, (the "Act") that allow direct appeals of final bankruptcy orders to the courts of appeals and permit bankruptcy attorneys to pay referral fees to nonprofit attorney referral programs, the ABA strongly opposes three other provisions in the new law, explained more fully below, that dramatically increase the liability and administrative burdens of bankruptcy attorneys while denying effective legal representation to many Americans. The ABA encourages the Subcommittee to support the draft legislation crafted by Sen. Jon Kyl last year that would reverse the harmful attorney liability provisions and replace them with appropriate new sanctions against debtors who lie to the court. We also urge the Subcommittee to support legislation that would add a partnership bankruptcy structure to the existing Bankruptcy Code.

Direct Appeals of Bankruptcy Court Orders

The ABA strongly supports Section 1233 of the Act, titled "Direct Appeals of Bankruptcy Matters to Courts of Appeals." That section, codified at 28 U.S.C. § 158, established a procedure that allows parties to appeal certain bankruptcy court decisions, judgments, orders and decrees directly to the circuit courts of appeals by means of a two-step certification and authorization process. The first step is a certification by the bankruptcy court, district court, or bankruptcy appellate panel, acting on its own motion or the request of a party, or all of the appellants and appellees acting jointly. The provision requires the lower court to certify the direct appeal if (i) the bankruptcy court, district court, or bankruptcy appellate panel determines that one or more of the standards are met or (ii) a majority of the appellants and a majority of the appellees request certification and represent that one or more of the standards are met. Once a direct appeal has been certified by the lower court, the second step is authorization by the circuit court of appeals. Under this second step, the court of appeals is given discretion whether to accept the direct appeal, and jurisdiction for the direct appeal will exist only in those cases in which the court of appeals chooses to authorize it.

The ABA believes that the direct appeals system created by Section 1233 is a clear improvement over the previous system of bankruptcy appeals. Under the earlier system, a bankruptcy order—unlike other federal trial court orders—was subject to an additional level of review: the appeal *first* had to go to either a district court or a bankruptcy appellate panel ("BAP") *before* the appeal could go to a circuit court. The two-level bankruptcy appellate process was extremely unusual. In our view, the multi-tiered bankruptcy appellate structure worked poorly and imposed unnecessary delays and costs on all parties. In addition, as stated in the Judicial Conference's 1995 Long Range Plan for the Federal Courts: "Under...[the previous] practice, district courts and BAP decisions are not treated as stare decisis in other cases—resulting in a 'patchwork' of differing legal interpretations that encourage forum shopping and undermine the national system of [a uniform] bankruptcy law." (p. 48) For these and other reasons, the bipartisan National Bankruptcy Review Commission voted unanimously in 1997 to support a direct appeals system.

Although the Act has not been in force long enough to generate conclusive data as to the effects of the direct appeals provision, the ABA believes that over time, the new system—which parallels the track of civil appeals much more closely than the earlier bankruptcy appellate system—will result in:

- Faster final decisions;
- Greater certainty, uniform interpretation, and decisions of precedential value with respect to key bankruptcy issues; and
- Reduction in unnecessary bankruptcy litigation.

Ultimately, the ABA believes that the direct appeals system created by the Act will aid in achieving the important goal of reducing the time and costs associated with the bankruptcy process and will also assist in harmonizing bankruptcy laws and non-bankruptcy laws generally.

Sharing Fees with Nonprofit Attorney Referral Programs

The ABA also supports Section 326 of the Act, titled "Sharing of Compensation," which amended Section 504 of the Bankruptcy Code to allow bankruptcy attorneys to pay referral fees to bona fide public service attorney referral programs. *See* 11 U.S.C. § 504. These nonprofit attorney referral programs, many of which are affiliated with state and local bars around the country, provide a valuable and highly visible service to the community by serving two critical functions: providing information to consumers about their legal concerns and, if appropriate, making a referral to an attorney who is capable of providing appropriate legal services to the consumer. Most of these referral programs in the U.S. support their operations by charging a percentage fee to each attorney who receives a case from the service, and this system has been very effective in the roughly 34 states that currently utilize this system.

Prior to the passage of the Act, the language of Section 504 of the Bankruptcy Code inadvertently prohibited bankruptcy attorneys from sharing their fees with these nonprofit lawyer referral programs. In particular, previous Section 504 of the Code prohibited fee-splitting arrangements except where (1) a person is a partner or otherwise associated with an individual compensated from an estate or (2) an estate-compensated attorney for a creditor who filed an involuntary case under Section 303 is assisted by another attorney. But this prohibition was similar to the general fee splitting prohibition applicable to all other types of lawyers contained in the ABA Model Rules of Professional Conduct, for which an exception had been made specifically for public service lawyer referral programs. By eliminating this irrational distinction between bankruptcy and non-bankruptcy lawyers and allowing the former to pay referral fees to nonprofit attorney referral programs, Section 326 of the Act has made a substantial contribution to the financial health of these nonprofit referral programs. As a result, this provision in the Code has benefited—and will continue to benefit—many thousands of consumers around the nation every year.

<u>Bankruptcy Attorney Liability Provisions</u>

The ABA and over 25 state and local bars throughout the country strongly oppose those provisions in the new law that require debtor bankruptcy attorneys to: (1) certify the accuracy of the debtor's bankruptcy schedules, under penalty of harsh court sanctions [*see* Section 102, codified at 11 U.S.C. § 707(b), *et al.*, and Section 319]; (2) certify the ability of the debtor to make future payments under reaffirmation agreements [*see* Section 203(a), codified at 11 U.S.C. § 524]; and (3) identify and advertise themselves as "debt relief agencies" subject to a host of new intrusive regulations that interfere with the confidential attorney-client relationship [*see* Sections 227-229, codified at 11 U.S.C. §§ 526-528]. The ABA believes that these attorney liability provisions in the Act, discussed in greater detail below, have been highly detrimental to the nation's bankruptcy system and should be repealed.

(1) *<u>Certification of Bankruptcy Schedules and Related Attorney Sanctions</u>*

The ABA strongly opposes the language in Sections 102 and 319 of the Act that requires the debtor's attorney to certify the accuracy of all factual allegations in the debtor's schedules of assets and liabilities and subjects the attorney to harsh court sanctions if any factual inaccuracies result in the dismissal of the debtor's Chapter 7 bankruptcy petition or in its conversion to a Chapter 13. During House-Senate conference committee negotiations in 2002 on a previous version of the legislation (i.e., H.R. 333), the provision requiring the court to impose sanctions against attorneys for inaccurate bankruptcy schedules was replaced with a discretionary standard. Although that change was a significant improvement, the current language contained in Sections 102 and 319 of the Act still will have significant negative effects on the bankruptcy system.

Prior to enactment of Sections 102 and 319, the debtors themselves were solely responsible for the accuracy of the schedules they filed with the bankruptcy court, and they were required to sign and certify these schedules under penalty of perjury. If the debtor filed false schedules, he or she was subject to strict sanctions and criminal penalties, including stiff fines and up to five years in prison. In addition, Bankruptcy Rule 9011 required both debtor and creditor bankruptcy attorneys, like all other attorneys appearing in federal courts, to certify that pleadings and other items that they prepare are supported by the facts before they are filed with the court. This rule, which was identical in form and substance to Federal Rule of Civil Procedure 11, applied to all pleadings and motions filed with the bankruptcy court. By its own terms, however, Rule 9011 did not apply to the bankruptcy schedules listing the debtor's financial information. Because those schedules are prepared almost entirely with information supplied directly by the debtor, Rule 9011 allowed bankruptcy attorneys to rely in good faith upon the accuracy of this information provided by the client. Therefore, the debtor alone was held responsible for the truthfulness and accuracy of the schedules.

Sections 102 and 319 of the Act changed existing law by creating a new and higher standard for debtor bankruptcy attorneys that goes well beyond the standards imposed upon other attorneys. By creating new subsections 4(A) – (D) to 11 U.S.C. § 707(b) and modifying Rule 9011, Sections 102 and 319 for the first time began to hold the debtor's attorney—instead of the debtor—financially responsible for any factual errors contained in the debtor's bankruptcy schedules. Therefore, if even innocent errors in the schedules result in the dismissal of the petition or in its conversion to a Chapter 13 proceeding, the debtor's attorney now can be held financially responsible unless it is proven that the attorney conducted a time-consuming and costly investigation of these factual allegations before the filing.

In addition, while previous Bankruptcy Rule 9011 held all bankruptcy attorneys to the same standards, Sections 102 and 319 of the Act unfairly discriminate between debtor and creditor attorneys. These sections provide that if the debtor's schedules are found to violate Rule 9011 and the debtor is denied a discharge under the means test outlined in the Act, the debtor's attorney will be subject to harsh court sanctions and could be held personally liable for the attorneys' fees of the trustee or bankruptcy administrator who contested the discharge, as well as civil penalties. Because malpractice carriers have indicated they will exclude this new liability from coverage under their policies or charge substantially higher rates and/or deductibles, the debtor attorney's exposure will be even greater. In contrast, attorneys representing creditors were not required to certify the accuracy of their clients' factual information and were not subjected to any comparable new sanctions under the new law.

The new standards outlined in Sections 102 and 319 of the Act also have fundamentally altered the attorney-client relationship in bankruptcy cases. It has transformed the attorney from an advocate to a detective and informer. The legislation created an unwaivable conflict of interest because the attorney is unable to accept information provided by the client at face value without risking liability if the information later proves to be inaccurate. Further, the debtor's attorney now is required to independently verify all of the client's factual representations. Indeed, many bankruptcy attorneys now believe they are required to hire private investigators and appraisers to confirm the existence

and value of all of the assets listed on the client's schedules.
Requiring the debtor's attorney to verify all of the client's representations has raised significantly the cost to the debtor of filing for bankruptcy. As a result of the new obligations and liability imposed on attorneys by Sections 102 and 319, many bankruptcy lawyers will no longer agree to accept debtors' cases because they are not willing to become their client's insurer. In addition, those bankruptcy lawyers who continue to represent debtors now are forced to charge substantially higher fees (which many debtors are unable to afford). Therefore, the practical effect of these provisions has been to deny many debtors timely, effective, and affordable representation just when they need it most. For all of these reasons, the ABA believes that Section 319 and new subsections 4(A) – (D) contained in Section 102 are counterproductive and should be repealed.

(2) *Certification of Reaffirmation Agreements*

The ABA also opposes those provisions in Section 203(a) of the Act that require attorneys to certify the debtor's ability to make future payments under reaffirmation agreements.

Under previous law, a debtor was not required to accept the discharge of all outstanding debt. Instead, the debtor could choose to reaffirm certain debts—and retain liability for these debts—if the attorney certified that the decision was voluntary and would not create undue hardship for the debtor or the debtor's dependants. Section 203(a) changes these procedures by again imposing new burdens on the debtor's attorney. Unlike the previous law, which simply required the debtor's attorney to certify in writing that the reaffirmation agreement was voluntary and would not cause the debtor undue hardship, the new provisions require the attorney to certify that "the debtor is able to make the [reaffirmation] payment," in cases where there is a presumption of undue hardship under the debtor's budget (i.e., if the debtor's monthly income is less than monthly expenses, including the reaffirmation payments).

Bankruptcy attorneys are not accountants and are neither trained nor equipped to conduct extensive audits of their clients' finances, nor do they make financial or household budgeting decisions for their clients. Indeed, this is not the attorney's proper role, and any attempt to force the attorney to assume these duties will substantially increase the cost of representing a debtor in bankruptcy. Therefore, this certification requirement, like the certification requirement in Sections 102 and 319, has discouraged many attorneys from representing debtors, while forcing the remaining debtors' attorneys to charge higher fees to cover the substantial additional costs and risk.

The new certification requirement contained in Section 203(a) of the Act also creates strong conflicts of interest between the debtor and the attorney in those instances when the debtor wants to reaffirm a debt and instructs the attorney to certify the debtor's ability to make payments. If the attorney follows the client's directive, the attorney may become subject to sanctions under Bankruptcy Rule 9011—or to a lawsuit by the creditor—if the debtor later proves unable to pay the reaffirmed debt. This new mandate is particularly unfair because creditor's attorneys are not subject to sanctions under Rule 9011 for their clients' false disclosures or illegal collection practices even if they acted in bad faith for vexatious purposes. For all of these reasons, the ABA believes that the provisions in Section 203(a) requiring debtors' attorneys to certify their clients' ability to make reaffirmation payments are inappropriate and should be repealed.

(3) "Debt Relief Agency" Provisions

The ABA also strongly opposes those provisions in Sections 227-229 of the Act that require bankruptcy attorneys to identify and advertise themselves as "debt relief agencies" and then comply with a host of new intrusive and burdensome regulations. These provisions confuse the public, seriously interfere with the attorney-client relationship, and impose unfair additional burdens and liability on debtors' attorneys that constitute an unjustified government invasion of the relationship between private attorneys and their clients.

Under these provisions, any "person"—including both bankruptcy attorneys and non-attorney "bankruptcy petition preparers"—who assists individual debtors with their bankruptcies in return for compensation is deemed to be a "debt relief agency." Unfortunately, the provisions fail to take into account any of the important differences between attorneys and non-attorneys providing bankruptcy services. Under current law, only attorneys are permitted to give legal advice, file pleadings, or represent debtors in bankruptcy hearings. In addition, unlike non-attorney bankruptcy petition preparers, only attorneys are licensed by the state in which they practice, bound by canons of ethics, and subject to discipline by the courts in which they practice. More importantly, only those communications between the debtor and his or her attorney are protected by the attorney-client privilege. Requiring both attorneys and non-attorney bankruptcy petition preparers to advertise themselves as "debt relief agencies" obscures these important distinctions while creating substantial confusion among the public.

The "debt relief agency" provisions in the Act also interfere with the attorney-client relationship in a variety of ways. Because the definition is worded so broadly, it may be construed to apply not just to bankruptcy attorneys, but also to family attorneys, tax attorneys, criminal and civil defense attorneys, and general practitioners who, in the course of representing their clients, are compelled to advise them to consider filing bankruptcy to protect their rights. This jeopardizes the attorney's ability to properly advise his or her client regarding their legal rights.

Any attorney who assists a client with bankruptcy will be subject to a long list of new regulations under the new law. In particular, such attorneys will be required to provide lengthy written disclosure statements to potential and existing bankruptcy clients that explain the bankruptcy system and provide general, government-approved legal advice. In addition, attorneys will also be required to advise the debtor in writing that the debtor need not be represented by a lawyer in the bankruptcy or in related litigation, which in many cases is bad advice.

By requiring that the debtor's attorney provide the debtor with preprinted, government-approved legal advice on bankruptcy law, and by forcing the attorney to state in writing that the debtor need not even retain a lawyer, the Act usurps the attorney's role as the proper legal representative of the debtor. Perhaps even more troubling, the Act also prohibits the attorney from giving certain proper pre-bankruptcy planning advice to the client, including advice to pay certain lawful obligations or to incur certain debts. In fact, these provisions are worded so broadly that the attorney could be subject to liability merely for making an unsuccessful attempt to help the client restructure the debt to avoid bankruptcy. These provisions, which dictate the types and content of legal advice that an attorney can and cannot render to his client, are particularly destructive of the attorney-client relationship.

Sections 227-229 also require attorneys to provide the debtor with a written contract, and if the contract fails to comply with each of the detailed requirements outlined in the Act, it would be void and unenforceable. Furthermore, if the debtor's attorney fails to follow any of the many technical requirements of the Act, the attorney could forfeit the entire fee and could be sued in state or federal court by the debtor, the trustee, or state law enforcement officials for actual damages, civil penalties, attorneys' fees, and costs. Although existing law and ethical rules require all attorneys to provide quality legal representation to their clients, Sections 227-229 go well beyond those general standards and unfairly subjects just one type of attorney—debtors' bankruptcy attorneys—to a far stricter standard than attorneys in any other field of practice.

In addition, Section 229 also seeks to micromanage the bankruptcy attorney's advertising by requiring the attorney to include a conspicuous—and awkward—statement in all its advertising stating that "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." No such requirements apply to creditors' attorneys under the Act. These new advertising regulations could conflict with the well-established advertising rules that have already been established by many state supreme courts and state bars and will confuse the public. In addition, requiring attorneys to label themselves as "debt relief agencies" will discourage general practitioners and bankruptcy professionals who have a consumer and business, debtor and creditor practice from advertising the availability of bankruptcy services, thus limiting consumer bankruptcy representation to attorneys with narrower practices. For all of these reasons, the ABA believes that the Act should be amended to exempt attorneys from the coverage of the "debt relief agency" provisions contained in Sections 227-229.

In recent months, the constitutionality of the "debt relief agency" provisions in the Act has been called into question by several federal courts around the country. On July 26, 2006, a U.S. District Court in Dallas—in the case of *Susan B. Hersch v. United States*—entered an order holding that as a matter of law, the portion of the debt relief agency provisions in the new statute prohibiting the rendering of certain legal advice violates the attorney's First Amendment rights.[1] Similar rulings also were issued by separate federal districts courts in Oregon—in the case of *Olsen v. Gonzales*[2]—and in Connecticut—in the case of *Zenas Zelotes v. Deirdre A. Martini.*[3] Meanwhile, on May 11, 2006, the Connecticut Bar Association and the National Association of Consumer Bankruptcy Attorneys filed suit in U.S. District Court in Connecticut challenging the constitutionality of these provisions. That suit seeks a preliminary injunction prohibiting application of these provisions to attorneys, but the court has not yet set a hearing date.[4]

All three attorney liability provisions outlined above, taken together, have been highly detrimental to the nation's bankruptcy system and substantially reduced the availability of *pro bono* legal representation. These provisions have discouraged many attorneys from agreeing to represent debtors at all and are making bankruptcy representation unaffordable for countless numbers of

---

[1] *See Susan B. Hersch v. United States*, No. 3:05-cv-02330 (N.D. Tex. July 26, 2006).
[2] *See Olsen v. Gonzales*, No. 6:05-cv-06365 (D. Ore. August 11, 2006).
[3] *See Zenas Zelotes v. Deirdre A. Martini*, No. 3:05-cv-1591 (D. Conn, November 7, 2006).
[4] The complaint and other materials filed in the case, *Connecticut Bar Association v. United States*, No. 3:06-cv-00729 (D. Conn.), are available online at http://www.nacba.org/media/press.php.

Americans. In addition, these provisions already have discouraged many attorneys from providing essential *pro bono* bankruptcy services to the nation's poor. Indeed, since the Act became law, many large law firms that previously encouraged its lawyers to provide *pro bono* bankruptcy representation to the poor are now instructing their lawyers that because of the new attorney-liability provisions in the Act, they may not accept any more such cases. With fewer attorneys available to represent debtors, many more debtors have been forced to file their bankruptcies *pro se*, without first obtaining adequate advice regarding the necessity or advisability of filing for bankruptcy. Unless these provisions are remedied, they will continue to have an adverse effect on debtors, creditors, and the bankruptcy system as a whole.

Sen. Jon Kyl (R-AZ), working with the ABA and the State Bar of Arizona, has crafted a bill that would reverse the harmful attorney liability provisions in the Act and replace them with appropriate new sanctions against debtors who lie to the court. The draft bill, known as the "Bankruptcy Reform Technical Amendments Act," would impose tough new *non-dischargeable* sanctions against debtors who lie on their bankruptcy schedules and new language urging the bankruptcy courts to more vigorously enforce existing Rule 9011 of the Federal Bankruptcy Rules when misconduct by any party is shown. The proposed amendments also would amend the definition of "debt relief agency" in the Act to exclude attorneys (who are already licensed and heavily regulated by their state supreme courts and state bars) while leaving these new regulations in the bill in place for the non-attorney bankruptcy petition preparers (who are now largely unregulated). If enacted, Sen. Kyl's bill would reduce bankruptcy fraud and abuse in a far more effective and equitable manner, and we urge all members of the Subcommittee to support it.

Partnerships in Bankruptcy

The ABA also believes that the Bankruptcy Code could be further improved by enacting legislation that would add a partnership bankruptcy structure to the Code.

Partnerships are a popular vehicle for doing business. Partnerships include the two person small business, the single asset real estate venture, and the large professional service firm. By its nature, the general partnership does not afford limited liability to its members. Rather, the liability of general partners for partnership debt is determined by state law and the partnership agreement. Consequently, the determination and enforcement of liability for the debts of an insolvent partnership involves a multitude of difficult and seemingly unanswerable questions.

The complexities of the intersection between partnership and insolvency laws have defied resolution. The result is that currently only one provision of the Bankruptcy Code—11 U.S.C. § 723—addresses a partnership bankruptcy. This section authorizes the trustee of a partnership in a Chapter 7 liquidation to claim and collect a deficiency of the partnership estate from a general partner and does not apply to Chapter 11 reorganizations.

In 1996, the ABA adopted policy recommending that Congress enact legislation providing for the administration and resolution of partnership cases under the Bankruptcy Code. The proposed amendments to the Bankruptcy Code, and the ABA resolution endorsing these amendments, are attached as Appendix A.

The estate of many partnerships, especially professional or service partnerships, can be preserved only by the Chapter 11 process. This fact has been exemplified by a number of recent bankruptcies involving insolvent professional partnerships, all of which involve remarkably similar facts.[5] Each involved either a large law or accounting firm which sought Chapter 11 bankruptcy relief to wind up its affairs. In each case, the bankruptcy court was forced to formulate a remedy that would encourage voluntary contribution by general partners to maximize the distribution of property of the state and simultaneously avoid unnecessary bankruptcy filings by partners and unnecessary litigation. It also became clear in each case that the issuance of an injunction or its equivalent to bar future actions against contributing partners was the *sine qua non* of the confirmed plan.

The ABA has carefully evaluated the problems and solutions set forth in the foregoing cases in formulating the proposed amendments to the Bankruptcy Code. The extended stay, which is analogous to a permanent injunction, is a key factor of the amendments. Although the foregoing cases involve large professional partnerships, the problems encountered and the resolutions embraced are equally applicable to all partnership bankruptcy cases.

As such, the ABA believes that the Bankruptcy Code should be amended so that a partnership bankruptcy will trigger an automatic stay of a limited duration of sixty days. Although general partners may be liable for some or all of the debts of the partnership under non-bankruptcy law, the courts have generally given heed to the literal language of the Bankruptcy Code and its legislative history negating the argument that the property of a partnership includes the property of its member general partners. Thus, the automatic stay has been generally held not to bar actions, proceedings, or acts directed against a general partner or its property.

Experience in the administration of partnership cases has demonstrated the crucial importance in Chapter 11 partnership cases of the issuance of an injunction against the enforcement of partnership creditors' rights against general partners and their property. The automatic stay will prohibit partnership creditors from exercising their collection efforts against partners or partners' property. The purpose of the automatic stay is to preserve the partners' property for distribution in the partnership case. By obviating the necessity for the partnership trustee or the partnership as a debtor-in-possession to seek and obtain an injunction against actions, proceedings and acts by partnership creditors directed against general partners, the extended stay accomplishes the same purpose and result for the benefit of the partnership creditors, insofar as the general partner's assets liable for the partnership debts are concerned, as the automatic stay of Section 362 does with respect to the partnership assets.

[5] These bankruptcy cases studied by the ABA include the following: (1) *Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey* (Bankr. S.D.N.Y.); (2) *Myerson & Kuhn* (Bankr. S.D.N.Y.); (3) *Laventhol & Horwath* (Bankr. S.D.N.Y.); (4) *Heron, Burchette, Ruckert & Rothwell* (Bankr. D.D.C.); and (5) *Gaston & Snow* (Bankr. S.D.N.Y.).

Further, the American Bar Association proposes an amendment that would allow the stay to be extended to non-debtor partners as a part of the confirmation of a plan. Courts should be permitted to issue an extended stay of actions, proceedings and acts against a general partner in a partnership case when the general partner has made a contribution to the payment of the partnership's debts, or assumed a commitment to make such a contribution in accordance with the provisions of a confirmed plan or order confirming a plan. Experience has demonstrated that recoveries by partnership creditors may be significantly enhanced if general partners can be persuaded to contribute to a recovery pool, post-petition future earnings, exempt property, and other assets not otherwise available to partnership creditors, in exchange for protection against collection suits by partnership creditors and suits for contribution and indemnification by copartners and the trustee of the partnership or the partnership as a debtor-in-possession.

Without the extended stay, individual creditors would sue individual general partners, and general partners would then cross-claim against each other for contribution and sue the debtor for indemnification. The probable result would be a costly and time-consuming web of litigation replete with attendant attachments, garnishments and executions. Personal bankruptcy would be a likely consequence for many. By preventing a haphazard scramble for the assets of general partners, and by facilitating an orderly distribution scheme, the permanent injunction under the extended stay ensures that general partners will be protected and that creditors' recoveries will be maximized. The extended stay should not bar actions, proceedings, or acts against general partners who do not assume a commitment or fail to fulfill a commitment to pay partnership debts. The extended stay does not constitute nor may it be deemed to be a release of joint tortfeasors. Because the extended stay is tied to confirmation of a plan, compliance with the "best interests of creditors" test, which is inherent in the confirmation process, is ensured.

In sum, the ABA urges the Subcommittee to support legislation, generally in the form of the attached Appendix A, to establish a partnership bankruptcy structure in the Code. As part of this new structure, the ABA endorses an automatic stay inhibiting post-bankruptcy suits against general partners for partnership liabilities, to remain in effect for sixty days after a bankruptcy filing. The ABA also believes that such an amendment should include automatic stays of transfers outside the ordinary course of non-bankruptcy property by general partners of the filing partnership.

Thank you for considering the views of the ABA on these important bankruptcy matters. If you would like more information regarding the ABA's positions on these issues, your staff may contact our senior legislative counsel for bankruptcy law issues, Larson Frisby, at (202) 662-1098.

Sincerely,

Robert D. Evans

Robert D. Evans

cc: All members of the Senate Judiciary Subcommittee on Administrative Oversight and the Courts

American City Business Journals
After a year, officials say bankruptcy reform is working
By Kent Hoover
23 October 2006

Bankruptcy filings are down by about 40 percent one year after new rules went into effect that require more debtors to repay their debts.

The number of filings, however, are gradually increasing, says Clifford White III, acting director of the Executive Office for U.S. Trustees, which oversees the administration of bankruptcy cases.
The **bankruptcy reform** law, which went into effect Oct. 17, 2005, requires debtors who have the means to repay debts to file under Chapter 13 of the bankruptcy code, which requires a repayment plan, instead of Chapter 7, which enables debtors to discharge unsecured debt.

The idea was to discourage abuse of the bankruptcy system.

"Initial results show promise," White says.

The means test used to determine whether debtors have the ability to repay their debts is working, he says. About 94 percent of the individuals who have filed for bankruptcy since the new law went into effect are below the median income. Only 10 percent of the filings by higher-income individuals appear to be attempts to abuse the bankruptcy system, White says.

But people who want to game the system can still do so, says Michelle White, a professor of economics at the University of San Diego.

The **bankruptcy reform** law prevents people from moving to states with high homestead exemptions, which shield home equity from creditors, and immediately filing for bankruptcy, she says. But other ways remain for opportunists to shelter their wealth -- including putting up to $1 million in retirement accounts and opening a new business -- and still qualify for Chapter 7, Michelle White says.

"The opportunists are going to have to work harder before they file, but they'll only be slightly affected," she says.

The new law mainly discourages bankruptcy filings by people who didn't plan to file but simply got over their head in debt, she says. In some ways, "the reforms have hit the wrong people," she told a symposium held by the American Bankruptcy Institute on the one-year anniversary of the law's effective date.

But Clifford White says bankruptcy remains available for "honest and needy" debtors. A number of cases have been brought against people who are trying to abuse the system, and judges are better able to determine abuse because of the additional information the new law requires.

"We're better off today than we were 13 months ago," he says.

December 5, 2006

The Honorable Jeff Sessions
Chairman
U.S. Senate Committee on the Judiciary
Subcommittee on Administrative
Oversight and the Courts
224 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

We are writing to express our gratitude for your support over many years for commonsense bankruptcy reform and to commend you for scheduling a hearing to review the steps taken to date to implement the provisions of the "Bankruptcy Abuse Prevention and Consumer Protection Act" (BAPCPA)(Pub. L. 109-8). Although the law is still new (some of the implementing regulations have not yet been finalized), the bipartisan and balanced bankruptcy reform it put into effect is already working to benefit consumers and the economy.

While consumer bankruptcy filing rates have dropped dramatically from 2 million in previous years to about 550,000 for 2006, there is no evidence we are aware of that individual debtors in need of bankruptcy relief have been unable to obtain it. In addition, the percentage of consumers choosing Chapter 13 repayment plans over Chapter 7 is higher than under the pre-reform law. This indicates that higher income filers are voluntarily utilizing court-supervised repayment plans.

As important as the decline in filing rates, BAPCPA's requirement for pre-filing credit counseling sessions has resulted in an overall increase in credit counseling sessions compared to 2005 levels. This means that substantially more Americans are getting the benefit of high-quality credit counseling from Justice Department-approved credit counseling agencies. In fact, the Department of Justice estimates that 10 percent of consumers who receive counseling chose an option other than bankruptcy. Individual debtors also enjoy substantial new benefits, such as the ability to shelter greater amounts of retirement funds and uniform disclosures to understand fully the implications of voluntary reaffirmations of debt.

The beneficial aspects of BAPCPA go far beyond its consumer bankruptcy provisions. For instance, small businesses now have access to a faster and less expensive filing process, the financial instruments netting provisions increase the stability of the global financial system, family farmers enjoy greater protections, and the cross-border provisions respond to the reality of the global marketplace. Moreover, the consumer privacy ombudsman provisions already have been implemented in a number of major Chapter 11 cases to assure that personal data protection remains strong during corporate reorganizations.

We applaud your Subcommittee's oversight efforts. Indeed, we believe that oversight could help correct some issues that might undermine the ability of the reform law to provide meaningful economic and social benefits to our nation. For example, the Judicial Conference forms that

December 5, 2006
Page 2

implement 707(g) (2) could disrupt the means-test by allowing debtors to claim deductions for phantom expenses and we feel that this should be corrected through the rulemaking process.

There is also a need to assure that adequate credit counseling resources remain available in the event that consumer filings increase substantially, and there is a clear need to monitor continuing abuses by some consumer debtor attorneys. In this regard, the Advisory Committee on Bankruptcy Rules recently agreed to study recommendations made by the American Bar Association that support new attorney discipline amendments to the Federal Rules of Bankruptcy Procedure to clarify the authority of the courts to discipline attorneys engaging in a pattern of misconduct, and to require district and bankruptcy courts to adopt and enforce local disciplinary rules and procedures. The Bar Association felt that new disciplinary powers were needed because state bar proceedings were not designed to police the obligations imposed by BAPCPA, particularly for high volume consumer bankruptcy practices. The Bar Association also concluded that bankruptcy courts have not generally adopted disciplinary rules and procedures, and the only systematic and effective disciplinary proceedings were found in the few bankruptcy courts that had implemented their own procedures.

While BAPCPA is new, its implementation so far has been relatively smooth and it is working remarkably well. In fact, many of the dark consequences predicted by opponents of the reform legislation have not materialized. Specifically, debtors are not being harmed by the new debtor counseling requirement, they are not being denied access to bankruptcy relief by the law's means testing provision, and they are not being subjected to harassment by creditors under non-dischargability or other provisions of the Act.

Therefore, we hope you agree that there is no need for further revisions to the Bankruptcy Code at this point. Instead, we urge Congress to let the reforms mature before considering further revisions. The implementation process and case law will add more context and detail to the new law, and Congress will then be in a better position to assess the long-term impact and effectiveness of bankruptcy reform, as well as determine whether clarifying or corrective amendments are justified.

We look forward to working with you and others in Congress to ensure that bankruptcy reform realizes its full potential. Thank you for considering our views.

Sincerely,

American Bankers Association
America's Community Bankers
American Financial Services Association
Consumer Bankers Association
Independent Community Bankers of America
The Financial Services Roundtable
Mortgage Bankers Association
Coalition for the Implementation of Bankruptcy Reform

Cc: Ranking Member Charles Schumer
Members of the Subcommittee

Testimony of
Mr. Steve Bartlett
On Behalf of
The Financial Services Roundtable
To The
Subcommittee on Administrative Oversight & the Courts
Senate Judiciary Committee

December 6, 2006

SUMMARY OF TESTIMONY

Good morning, Mr. Chairman and Ranking Member Schumer, my name is Steve Bartlett and I am President & CEO of The Financial Services Roundtable. Thank you for inviting me to participate in this hearing to examine the implementation of Public Law 109-8, the bankruptcy reform statute that became effective on October 17, 2005. I would also like to express my appreciation to the Department of Justice for providing leadership in implementing the provisions of Public Law 109-8.

Mr. Chairman, I have several attachments to my statement and I would ask that they be included in the record.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Our companies account directly for $50.5 trillion in managed assets, $1.1 trillion in revenue, and more than 2.4 million jobs. As you might imagine, Roundtable members are in a good position to assess impact of legislative changes such as bankruptcy reform.

The American consumer is the lifeblood Roundtable companies and it is in the best of interests of Roundtable member companies to have well-educated consumers who manage debt prudently.

Public Law 109-8 is just over one year old. So far, from the perspective of the American consumer and the economy, the new bankruptcy reform law is working quite well. Bankruptcy filings are down, more Americans than ever are getting credit counseling and, as a result, consumers are better educated about prudent financial management. Let me cite some statistics to demonstrate my point:

- consumer bankruptcy filing rates have dropped dramatically to an annualized rate 600,000 from an average annualized rate of 1.5 million for the prior 5 five years
- more consumers are choosing repayment plans under Chapter 13 repayment plans over Chapter 7 than under the old law, from 27.5% under the old law to 40% under the new law
- there were 157,417 total credit counseling sessions at Justice Department-accredited agencies in October of 2006 (73,171 for traditional counseling, 57,220 for pre-bankruptcy counseling and 26, 811 for pre-discharge education counseling), compared to an average of 57,087 total counseling sessions for per month for 2005

These numbers indicate that the means-test and the pre-bankruptcy credit counseling mandate are working. Recall that the principal policy objective of bankruptcy reform was to say that people with above-median income who can repay some or all of their debts ought to do so. That seems to be happening under the new law.

One major result of bankruptcy reform is increased credit counseling, which educates consumers. Credit counseling can help keep consumers from getting into financial trouble and, for those consumers for whom bankruptcy is an appropriate option, credit counseling keeps consumers out of financial trouble in the future.

In fact, the Department of Justice recently estimated that 10% of consumers who get pre-bankruptcy counseling don't file for bankruptcy. Counseling is widely available from numerous sources through multiple channels - in-person counseling, telephone counseling and Internet counseling. Frankly, we think the number of consumers who decide not to file for bankruptcy could be higher. We need to reach consumers much sooner in the financial cycle so that credit counseling can live up to its full potential. If consumers wait until they are completely underwater, counseling may not live up to its full potential.

The non-profit counseling agencies, both NFCC and AICCA agencies, have stepped up to the plate to make bankruptcy reform work. They applied to become certified agencies and promised to live by the ethical requirements established by the Justice Department. They perform a valuable public service by providing financial management advice to consumers and the lending industry is pleased they choose to participate in the pre-bankruptcy counseling process. We are all better off for the efforts of these agencies. They are on the front lines and bear the heavy load. Based on the reports we have received from most of the approved agencies, it seems clear these agencies are acting as Congress intended. For instance, we believe they are waiving counseling fees about for those who can't pay. In October, 2006, fees were waived for 22% of counseling sessions. And fees are relatively modest at about $36 per session. The lending industry created a grants program for approved agencies, of which there are 153.

The industry has also created a website - mymoneymanagement.com - which guides consumers to DOJ-approved agencies. Some of our member companies are already directing customers to this site as soon as they show signs of financial difficulties to assist consumers earlier in the process.

It is important to understand that Justice Department certification is a significant enhancement for the quality of credit counseling available to consumers. There has not been a governmental "seal of approval" that identifies quality agencies before. Also, the increased attention around bankruptcy reform and credit counseling has driven up demand for credit counseling.

While much of the attention has focused on pre-bankruptcy counseling, post-bankruptcy educational counseling is immensely important.

This counseling comes at a very important time for the average consumer. The consumer, having filed for bankruptcy, will be ready to learn new financial skills.

While much the public debate has focused on pre-bankruptcy counseling, the Roundtable believes that this requirement could be improved by regulations. In a comment letter, we suggested that pre-bankruptcy certificates should be valid for one year, rather then merely 6 months, to allow consumers more time to consider alternatives to bankruptcy. The Roundtable submitted a letter to the Department of Justice detailing regulatory changes and I have attached that letter to my statement.

The Roundtable strongly believes each issue can be addressed through regulatory implementation strategies designed to further Congressional intent.

To sum it up, Mr. Chairman, I would say "so far, so good." Bankruptcy reform is working. Prior to enacting Public Law 109-8, Congress had not reformed bankruptcy laws since 1978. We need to let the law mature before considering any legislative changes.

Congress did the right thing for consumer and the economy in passing bankruptcy reform; now it's time to make sure that this legislative success is implemented correctly.

However, there are implementation challenges. For instance, as will be discussed in my full statement, the forms being produced by the Judicial Conference have the potential to disrupt the means-test by allowing debtors to claim deductions for non-existent expenses, for a car they do not own, for example. Bankruptcy reform was surely not intended to allow above-median income debtors to escape repayment by deducting expenses they don't actually have. We feel that this issue, as well as any others, should be addressed through the rulemaking process.

In conclusion, I would make several points. The bankruptcy reform legislation passed both the House and the Senate by wide, bi-partisan margins. The new law is working for the consumer and the economy. Those in need still have full access to bankruptcy and above median income people who can repay a portion of their debts do so. Bankruptcies are down; quality credit counseling is up; consumers have access to better information about financial management. What we need now is careful, bi-partisan oversight.

I thank the Subcommittee for conducting this hearing, and I am grateful for this opportunity to testify. I look forward to answering your questions.

TESTIMONY OF STEVE BARTLETT

Good morning, Mr. Chairman and Ranking Member Schumer, my name is Steve Bartlett and I am President & CEO of The Financial Services Roundtable. Thank you for inviting me to participate in this hearing to examine the implementation of Public Law 109-8, the bankruptcy reform statute that became effective on October 17, 2005. I would also like to express my appreciation to the Department of Justice for providing leadership in implementing the provisions of Public Law 109-8.

Mr. Chairman, I have several attachments to my statement and I would ask that they be included in the record.

THE FINANCIAL SERVICES ROUNDTABLE

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $50.5 trillion in managed assets, $1.1 trillion in revenue, and more than 2.4 million jobs. As you might imagine, Roundtable members are in a pretty good position to assess impact of legislative changes such as bankruptcy reform.

OVERVIEW OF IMPLEMENTATION AND MACROECONOMIC PERSPECTIVE ON REFORM

Mr. Chairman, at least since the turn of the twentieth-century, the American people have always had access to bankruptcy when overwhelmed and unable to repay their debts. This is as it should be. There is no reason to force people to toil under the burden of debts they can never repay. For this reason, we have had a "fresh start" enshrined in our bankruptcy laws since 1898. During the Great Depression in 1930s, Congress created voluntary repayment plans as an alternative to straight liquidation.

However, as originally envisioned, straight liquidation under Chapter 7 was meant to be a last resort for people with no ability to pay. Congress continued America's progressive tradition by enacting Public Law 109-8 to channel higher income consumers into repayment plans while permitting the truly destitute and the poor to go into straight liquidation. The Roundtable supports both the letter and spirit of these important reforms.

Mr. Chairman, to provide a quick explanation of how the new law is being implemented, I would say the sense of the Roundtable member companies is that the law is working well and consumers as well as the economy are benefiting.

The number of bankruptcy filings has plummeted since 2004 and 2005. Some of this was certainly due to people rushing to file under the old law. Our companies and most analysts who have looked at the situation believe the drop off in filings is due to more than just people filing in 2005 to beat the new law.

We agree with those in Congress who have recently pointed out that losses to the economy that result from bankruptcy filings slow economic growth to some extent. When a business – any business, large or small - loses money because a customer files for bankruptcy, the business often has to increase what it charges other customers. I would submit that this is not good for consumers or the economy.

I know that some, including Senator Grassley who sits on this Subcommittee, have considered the effect of Public Law 109-8 and have put the total costs savings to the American economy at around $60 billion. Reduced losses of this size are a positive for the economy.

This leads me to my first question I would identify for the Subcommittee: How has bankruptcy reform affected the American economy? The answer to that question will take a cumulative effect over the next few years, but it is an important question to ask.

The low rate of consumer bankruptcies presents other significant questions for the Subcommittee as it tries to assess the success or failure of Public Law 109-8.

- Is the infrastructure in place to handle a surge in filings; specifically, are there enough certified credit counselors?
- Does the Department of Justice have enough resources to implement the means test?

I don't know the answers to these questions yet. I would, however, urge diligent monitoring of the implementation of the new law to ensure there are adequate resources available to make the system work.

CREDIT COUNSELING

I would also like to mention the potential for social and economic good coming from the pre-bankruptcy credit-counseling mandate. As the Subcommittee knows, in order to file for bankruptcy under the new law, a consumer must first get a certificate from an approved counseling agency attesting to the fact that the consumer has completed a counseling session. A certificate is good for 6 months. And, prior to receiving a discharge of debt, a consumer must undergo another counseling session designed to teach on-going financial skills.

The Department of Justice has publicly stated that they believe around 10% of the pre-bankruptcy certificates issued have not been used yet. This is a positive sign. But I think we can do better.

The industry funded a "no-strings-attached" grants program for every approved agency that sought a grant. There are 153 approved pre-bankruptcy counseling agencies and another 275 agencies have been approved to provide post-bankruptcy educational counseling.

These non-profit agencies, both NFCC and AICCA agencies, perform a valuable public service by providing financial management advice to consumers and we are pleased they choose to participate in the pre-bankruptcy counseling process. Based on the reports we have received from over 70% of approved agencies, it seems clear these agencies are acting as Congress intended. For instance, we believe they are waiving counseling fees about for those who can't pay. In October, 2006, fees were waived for 22% of counseling sessions. And fees are relatively modest at about $36 per session.

In addition, there has been a dramatic increase in traditional credit counseling sessions this year as compared to last year, which may be linked to the new law. I have attached to my statement a report prepared for the

Roundtable that discusses what most approved counseling agencies are telling us about the situation on the ground.

One difficulty the Roundtable has identified is how to get to consumers sooner in the financial cycle. If we just wait until consumers are completely "under water," it may be that the counseling mandate will not live up to its full potential. To make counseling more effective, the Roundtable has created a website - mymoneymanagement.com - that refers consumers to DOJ-approved agencies for credit counseling *before they are considering bankruptcy*. In fact, some of our member companies are now directing their customers who fall behind in payments to this website so those consumers can get help earlier. All of us in the responsible lending community hope this will help consumers sooner, to the benefit of everybody.

I have one final note on credit counseling. As can be seen in my attachment, the Roundtable has received scattered reports that bankruptcy attorneys have been seeking to blunt the effect of the counseling mandate by steering clients to agencies they consider “friendly.” We have been told by counseling agencies that in some cases attorneys pay directly for the counseling services. I would suggest to the Subcommittee that these business practices, if they continue, could erode the significant potential consumer benefits of pre-bankruptcy counseling. I am aware that members of the Subcommittee have written a letter to the Deputy Attorney General about one specific agency and the Roundtable applauds this oversight initiative.

THE MEANS TEST

In addition to credit counseling, one of the centerpieces of bankruptcy reform was the means test. In this regard, I would make several observations to the Subcommittee. The good news is that during the last year, the number of objections to the means-testing filed in court has been modest. The Department of Justice is diligently implementing the means-test.

In addition, to date, no creditor has filed a means-test objection as it has the right to do under the new law. I think this is so in part because higher income debtors are either skipping bankruptcy or are self-selecting to go into Chapter 13. Thus, there is *no evidence* at all to support the fears expressed by some before enactment of Public Law 109-8 that creditors would use this new right inappropriately.

The Subcommittee should know that one positive effect of the new law which I attribute to the means test is an increase in the number of Chapter 13 cases relative to Chapter 7 cases. It seems as if more consumers are opting for Chapter 13 in light of the new law. This is certainly a positive trend and one of the major goals of the legislation.

The final point I would make regarding the means-test involves the Judicial Conference rule making process. In particular, I would call the Subcommittee's attention to the fact that the forms created to measure repayment capacity to implement the means test seems to allow debtors to calculate repayment ability by deducting for expenses they don't actually have. For instance, consumers are directed to deduct an expense for owning a car even if they don't own one.

The Roundtable believes that this creates an inaccurate measure of repayment ability. The means test was designed by Congress to accurately measure repayment ability; allowing debtors to deduct phantom expenses is not consistent with Congressional intent. I have attached to my statement a letter submitted by associations commenting on the Interim Rules and making this point.

CONSTITUTIONAL CHALLENGES TO PUBLIC LAW 109-8

Mr. Chairman, the very full legislative record developed by Congress before the enactment of Public Law 109-8 focused on the manner in which debtor attorneys were responsible for abuses of the system. I certainly would never want to paint all attorneys as corrosive to the bankruptcy process. I know there are many well-intentioned and serious attorneys who represent consumers considering bankruptcy in an appropriate way. But, as the hearing record makes clear, there were bankruptcy mills that simply processed consumers without providing meaningful legal advice or looking out for the best interests of consumers. The Federal Trade Commission even issued a warning to the public about deceptive advertising by attorneys.

Congress sensibly reacted by imposing disclosure requirements on attorneys and prohibiting them from advising consumers to defraud creditors. These consumer protections were designed to help consumers by giving them full access to all the information they need to make informed choices.

So, it is with some concern that I must call the Subcommittee's attention to a lawsuit filed in Connecticut to have these consumer protections declared unconstitutional. The plaintiffs in this case believe that attorneys have a right under the Constitution to deceive the public or hide information from clients or advise consumers to commit fraud by running up debts just before filing for bankruptcy to game the means-test.

The Justice Department is aggressively litigating on the other side of the issue. However, if these consumer protections are invalided by judges, I hope Congress can find some way to protect unwary and unsophisticated consumers from the kinds of deceptive practices the Federal Trade Commission warned about.

CONCLUSION

In conclusion, I would make several points. The Roundtable supported bankruptcy reform and was pleased to see the legislation pass both the House and the Senate by wide, bi-partisan margins. The new law seems to be working for the consumer and the economy. It is working better than anticipated – those in need still have full access to bankruptcy and upper income people seem to be skipping bankruptcy or opting for repayment plans. Bankruptcies are down; more Americans are getting quality credit counseling; consumers have access to better information about financial management. What we need now is careful, bi-partisan oversight.

I believe that Public law 109-8 has the potential to be of continuing great benefit to consumers and to the economy. As I said at the beginning of my testimony – "so far, so good." The work of the Congress is not over. There are challenges and surely there will be unforeseen bumps in the road. I thank the Subcommittee for conducting this hearing, and I am grateful for this opportunity to testify. I look forward to answering your questions.

COMMERCIAL LAW LEAGUE OF AMERICA®

Position Paper Submitted to the United States Congress by the Commercial Law League of America and its Bankruptcy Section

Critical Technical Issues Regarding Public Law No. 109-8
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

September 7, 2005

The Commercial Law League of America ("CLLA"), founded in 1895, is the nation's oldest organization of attorneys and other experts in credit and finance actively engaged in the field of commercial law, bankruptcy and insolvency. Its membership exceeds 3,100 individuals. The CLLA has long been associated with the representation of creditor interests, while at the same time seeking fair, equitable and efficient administration of bankruptcy cases for all parties in interest.

The Bankruptcy Section of the CLLA is made up of approximately 1,450 bankruptcy lawyers and bankruptcy judges from virtually every state in the United States. Its members include practitioners with both small and large practices, who represent divergent interests in bankruptcy cases. The CLLA has testified on numerous occasions before Congress as experts in the bankruptcy and reorganization fields.

INTRODUCTION

On February 20, 2001, the CLLA submitted to the United States Congress its Technical Problems with S. 220 and H.R. 333, a position paper dedicated not to the substance of the bankruptcy reform legislation then pending, but to drafting issues that appeared to be in clear error, inconsistent with Congressional intent or which render certain provisions unworkable in practice.

Although the CLLA was pleased to see that a number of issues we discussed in our prior technical problems paper were addressed, as reflected in S. 256, which was enacted into law on April 20, 2005, as the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") some important problems were not resolved. Moreover, since 2001, both additional amendments made to various versions of the bankruptcy reform legislation and an increasing body of academic analysis have necessitated further corrections.

Within hours of the enactment of S. 256, an example of the need for technical revision presented itself. Section 325 provided for an increase in the bankruptcy filing fees and amended the apportionment of those fees among the General Fund of the Treasury, the United States Trustee

70 East Lake Street, Suite 630 • Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

COMMERCIAL LAW LEAGUE OF AMERICA®

program and the Judiciary. The problem arose in that the fee increases were governed by the general effective date, or 180 days from enactment, while the apportionment changes were of immediate effect. Congress corrected this problem via a provision in H.R. 1268, the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005, which was signed into law on May 11, 2005.

Many more such problems will come to light on and after the October 17, 2005, effective date for the majority of the new Act's provisions. These problems should be afforded no less priority than was given Section 325.

The CLLA therefore urges the Congress to remedy the Act's technical defects and to do so promptly so as to avoid the confusion that will surely arise if certain of the Act's provisions are permitted to become effective without amendment. In order to better demonstrate the need for such an amendment, and to assist the Congress in this regard, the CLLA has set forth below a number of the more pressing technical problems with the Act. [1]

ANALYSIS

Section 102(a)(2)(C)

Section 102(a)(2)(C) of the law creates a new § 707(b)(3) of the Bankruptcy Code ("Code"), which addresses conversion or dismissal for abuse other than under the means test. This new Code section provides:

> (3)In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider –
>
> (A) whether the debtor filed the petition in bad faith; or
> (B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

The phrase "subparagraph (A)(i) of such paragraph" should be "subparagraph (A)(i) of paragraph (2)" because there is no "subparagraph (A)(i)" in § 707(b)(1), and the presumption to which this subparagraph refers is the means test, which is codified at § 707(b)(2).

---

[1] This analysis did not cover Sections 501 – 502 (municipal bankruptcies) and Sections 901 – 911 (financial contracts).

70 East Lake Street, Suite 630 • Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

In addition, subparagraph (B) should begin with "whether" or, alternatively, "whether" should be inserted between "consider" and the dash at the end of the paragraph (3) language and deleted from subparagraph (A).

Section 102(c) and (d)

Section 102(c) amends Code § 704 to require that the United States trustee or bankruptcy administrator "review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b)." The court is required to send this statement to creditors within five days of receipt.

Section 102(d) amends Code § 342 to require that in cases in which the presumption of abuse arises, the bankruptcy court clerk must give written notice to all creditors not later than 10 days after the petition date, that the presumption has arisen.

These two provisions, which deal with precisely the same subject matter, are obviously in conflict and not amenable to reconciliation.

The CLLA recommends that Section 102(d) be stricken to resolve the conflict because, unlike Section 102(c), it has no mechanism for determining whether the presumption of abuse has arisen and the United States trustee is much better suited to making this determination than is the clerk of the bankruptcy court.

In addition to the above, Section 102(c) incorrectly amends § 704 to impose a duty on the United States trustee. Code § 704, however, sets forth the duties of a trustee, an entity quite distinct from the United State trustee, whose duties are set forth at 28 U.S.C. § 586.

Section 104

Section 104 amends § 342(b) of the Code, is amended to read as follows:

> '(b) Before the commencement of a case under this title by an individual whose debts are primarily consumer debts, the clerk shall give to such individual written notice containing--
>
> '(1) a brief description of--
>
> '(A) chapters 7, 11, 12, and 13 and the general purpose, benefits, and ***costs of proceeding*** under each of those chapters; and

The highlighted language may create confusion and uncertainty as to the actual costs of filing bankruptcy verses the filing fees for each of the different proceedings under Title 11. Although it

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

COMMERCIAL LAW LEAGUE OF AMERICA®

is unlikely the drafters' intent, the word "costs" can have both monetary and non-monetary meaning. While costs could relate to filing fees, it could also relate to loss of credit rating or the inability to obtain favorable financing terms in the future. Costs may also relate to various taxable costs incurred in an adversary proceeding or other expense that the debtor's attorney may charge.

In order to clarify the meaning, the highlighted portion should be changed to "filing fees for proceeding".

Although the former § 342(b) required the clerk to provide an individual debtor with disclosure information prior to filing, such an obligation is unrealistic. Except in the case of a *pro se* debtor who receives the information at the time the clerk accepts the petition for filing, the clerk will not be able to personally give each debtor a copy of the disclosure. This can be corrected by amending paragraph (b) as follows:

> "(b) Before the commencement of a case under this title by an individual whose debts are primarily consumer debts, the debtor's attorney, the debtor's bankruptcy petition preparer, or the clerk if the debtor has not retained an attorney or bankruptcy petition preparer, shall give to such individual, written notice prepared by the clerk containing –"

Section 106

Section 106 amends § 362 of the Code by adding subsection (i), which reads:

> If a case commenced under chapter 7, 11, or 13 is dismissed due to the creation of a debt repayment plan, for purposes of subsection (c)(3), any subsequent case commenced by the debtor under any such chapter shall not be presumed to be ***filed not in good faith.***

The highlighted language is confusing and should be changed to "filed in bad faith."

Although neither "good faith" nor "bad faith" are defined in the Code, both terms are used throughout the Code. Alternatively, the language could read ". . . shall be presumed to be filed in good faith." Either form of the change appears to have the same meaning and conveys the law in a less confusing manner.

Section 201

Section 201 allows the court to reduce a creditor's claim by up to 20 percent based on the creditor's conduct with respect to prepetition workout arrangements with the debtor. The standard used in this Section, however, is unclear because it refers to the creditor's unreasonable refusal to negotiate with the debtor and its unreasonable refusal to consider the debtor's proposal Because a refusal to consider an offer is not the same as a refusal to negotiate, the statute is

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

difficult to interpret and to apply. Congress should determine which behavior it intended to proscribe and use the same term throughout the statute.

In addition, if the purpose of this amendment is to encourage creditors to work with debtors and avoid a bankruptcy filing, Congress should consider conferring standing to pursue the Section's remedy on the trustee and other creditors having a claim in the case. The debtor has no real incentive to seek a reduction in the unreasonable creditor's claim and it is the other creditors, not the debtor, that are harmed when a creditor acts in the manner this Section seeks to discourage.

Sections 223 and 1209

Section 223 creates a new priority for "allowed claims for death or personal injuries resulting from the operation of a motor vehicle or vessel if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance."

Section 1209 expands the exception to discharge for the same class of claims, but defines those debts as arising from the debtor's operation of a motor vehicle, vessel, ***or aircraft***.
To the extent Congress intended that the same debts that are excepted from discharge also be entitled to priority, amendment is required.

Section 229

Section 229 adds new Code § 528, which provides that not later than 5 days after first meeting with an assisted person, a debt relief agency ***shall*** execute a contract with such assisted person explaining the services to be provided and the charges for such services. To the extent that following the first meeting an assisted person decides not to file bankruptcy or decides to seek assistance from a different debt relief agency and does not execute a contract with the original debt relief agency, that debt relief agency may be in violation of § 528(a)(1). The section should contain a provision excusing the debt relief agency from compliance if the assisted person decides not to use that debt relief agency's services.

Sections 304 and 305

Sections 304 and 305 both amend Code § 521 regarding the period within which the debtor must act stated as 30 days from the first date set for the Code § 341 meeting of creditors in § 521(a)(2) and 45 days in § 521(a)(6), in doing so however, they create inconsistent time periods within which a debtor must surrender or redeem collateral, or reaffirm the underlying debt, as indicated on the statement of intention.

Additionally, in order to prevent the subject property from ceasing to be property of the estate and protected by the automatic stay, the trustee must file a motion with the court before the debtor is required to perform the statement of intention. Beyond the practical problems of cost

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

and potential detriment to other creditors, this requirement forces the trustee to file motions that are premature and speculative as to the necessity for relief, a position the law has historically disfavored and which may violate the case or controversy requirement of the Constitution.

A possible resolution for both of these issues is to maintain the 30 day time period for the debtor's performance of the statement of intention, with the creditor providing prompt notice to the trustee upon the debtor's failure to perform. The trustee would then have the additional 15 days to file the motion necessary to retain the subject property within the estate as well as the continued application of the automatic stay.

Section 313

Section 313 amends Code § 522(f) as it relates to a debtor's ability to avoid a non-possessory, non-purchase money security interest in certain goods to the extent the security interest impairs the debtor's exemption. Section 313, however, was not properly drafted. Code § 522(f)(1)(B) currently permits a debtor to avoid a non-possessory, non-purchase money security interest, to the extent it impairs an exemption in:

- household furnishings, ***household goods***, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
- implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or
- professionally prescribed health aids for the debtor or a dependent of the debtor.

Section 313 adds paragraph (4) to § 522(f), which defines "household goods" to mean clothing; furniture; appliances; 1 radio; 1 television; 1 VCR; linens; china; crockery; kitchenware; educational materials and educational equipment primarily for the use of minor dependent children of the debtor; medical equipment and supplies; furniture exclusively for the use of minor children, or elderly or disabled dependents of the debtor; personal effects (including the toys and hobby equipment of minor dependent children and wedding rings) of the debtor and the dependants of the debtor; and 1 personal computer and related equipment.

Thus, the specific list of "***household goods***" coexists with household furnishings, wearing apparel and the other items that were included in Code § 522(f) before the amendment. This not only creates duplication and some degree of ambiguity, but also frustrates the intent, which is to limit and state with specificity the items susceptible to lien avoidance.

Section 315

Section 315 (b) amends Code § 521, adding the following language to new (a)(l)(B)(iii):

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

a statement of the debtor's financial affairs and, if section 342(b) applies, a certificate –

(I) of an attorney whose name is indicated on the petition as the attorney for the debtor, or a bankruptcy petition preparer signing the petition under section 110(b)(1), indicating that such attorney or the bankruptcy petition preparer delivered to the debtor the notice required by section 342(b); or

(II) if no attorney is so indicated and no bankruptcy petition preparer signed the petition, of the debtor that such notice was received and read by the debtor;

Code § 342(b) also requires that "Before the commencement of a case under this title by an individual whose debts are primarily consumer debts, ***the clerk*** shall give to such individual written notice containing –".

The problem is that Code § 521 makes it the duty of the attorney or petition preparer to file a statement that the debtor has been provided with the statement required in § 342(b); however, § 342(b), as amended, requires the clerk to provide such statement to the debtor ***before*** filing a petition. There is no indication in § 342(b) as to how the clerk is to provide a represented debtor with the required statement prior to a petition that is filed electronically or why the clerk should have that responsibility, given that the attorney is already required to provide the debtor with the information.

Code §§ 342(b) and 521 should be consistent; this can be achieved by amending § 342(b) to state:

> "Before the commencement of a case under this title by an individual whose debts are primarily consumer debts, the debtor's attorney or bankruptcy petition preparer, or in the event that the debtor files a petition without the assistance of an attorney or bankruptcy petition preparer, the clerk shall give to such individual written notice containing . . ."

<u>Section 318</u>

Section 318 adds language into § 1325(b)(1)(B) of the Code so that it reads as follows:

> "the plan provides that all of the ***debtor's*** projected ***disposable income*** to be received in the ***applicable commitment*** period beginning on the date that the first payment is due under the plan will be applied to make payments **to *unsecured creditors*** under the plan."

The highlighted language could be read to require that ***all*** of the ***debtor's disposable income*** is to be paid to unsecured creditors; this does not appear to be the intent of the revision.

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

The intent of the revision could be made clearer by inserting the following language (in ***italics***): ". . . will be applied to make payments to unsecured creditors ***as provided for*** under the plan."

Section 322

Section 322 attempts to remediate one of the more egregious abuses under the Code, the homestead exemption, by establishing a $125,000 cap. Interpreting the plain language of new Code § 522(p), specifically the phrase "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law," an Arizona bankruptcy court held that the homestead cap applies only in the handful of states in which a debtor may choose between the applicable state or federal exemption scheme. In other words, the "opt out" states are not subject to the cap at all. *See In re McNabb*, 2005 Bankr. LEXIS 1231 (Bankr. D. Ariz. June 23, 2005).

Under a plain language analysis, the Arizona court appears to be correct, but even the court acknowledged that this may be due to a technical "glitch" in the Act. The CLLA believes it is and should be remedied, particularly in light of the expressed desire of Congress to eliminate abusive bankruptcy filings.

Section 328

Section 328 amends Code § 365(b)(1)(A) in a manner that is extremely difficult to understand and, as such, creates a minefield for litigation and increased costs to the estate and its creditors. The amended Code section provides (with the amended language highlighted):

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee –

> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default ***other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph***;

The amendment objective is unclear. The general exception to the cure requirement – a breach of a provision ***relating to*** the satisfaction of any provision ***relating to*** a default ***arising from*** any

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

failure to perform – is so ill-defined as to border on nonsense. The CLLA assumes that it is the last part of the exception, that is, a failure to perform that results in a breach of the contract or lease, that is the true object of the amendment, but the enacted language renders our assumption dubious, even if correct.

The amendment's use of punctuation is improper. In addition, the placement of a comma between "real property" and "if it is impossible" without a corresponding comma after "default" throws off the entire subparagraph, everything between "such default" the first place it appears and "real property," becomes a clause unto itself. As such, the "if it is impossible" clause relates to the initial language of the subparagraph, that the trustee must cure defaults, or provide assurance of cure, before assumption. The result is obviously illogical because cure would be required only where it is impossible to do so.

The amendment language is also redundant. The "if it is impossible" clause creates further problems because of its reference to "such default" after "default" which is used three times, each of which appears to refer to a distinct default separate from the others. The vagueness thereby created, is exacerbated by the exception to the "if it is impossible" clause, which applies to nonresidential real property leases, while the first exception to the general rule of § 365(b)(1) applies to unexpired leases of real property.

Despite the problems with the language of Section 328, its purpose is a needed remedy for situations in which a prepetition default, on the part of the debtor precludes reorganization simply because cure is impossible. The CLLA observes, however, that Congress did not fully remedy this problem because the Section 328 amendment has no application to executory contracts even though the impossibility problem is identical to that arising where real property leases are concerned. If this disparity was created through oversight, the CLLA recommends an immediate correction. If intended, the CLLA suggests that Congress reconsider the distinction it has created and the negative consequences that are likely to follow.

The CLLA therefore recommends that the language added to Code § 365(b)(1) by the Act be stricken in its entirety. The exception Section 328 creates should be added at the end of Code § 365(b)(2), which deals generally with exceptions to the cure requirement of paragraph (1), and should read as follows:

> (E) nonmonetary obligations if it is impossible for the trustee to cure such breach by performing nonmonetary acts at and after the time of assumption, except that if such breach arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption and pecuniary losses resulting from such breach shall be compensated in accordance with the provisions of paragraph (1).

If this suggestion is not adopted, then Section 328's amendment to Code § 1124(2)(A) should be corrected such that the second occurrence of "section 365(b)(2)" be changed to "section

70 East Lake Street, Suite 630 • Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

365(b)(1)." With or without the CLLA's suggested amendment, Code § 1124(2)(D), as amended by Section 328, requires a correction in order to make it consistent with § 365(b). In its current form, the latter requires compensation for pecuniary loss resulting from the debtor's failure to operate under a nonresidential lease, while the former states that such a claim is not impaired if a Chapter 11 plan does not provide that very compensation.

Section 404

Section 404 amends Code § 365(d)(4). In § 365(d)(4)(B)(I) the amendment states that the court may extend the 120-day period "for 90 days on the motion of the trustee or lessor for cause." The term "lessor" should be "lessee," as it is the lessee that has the right to seek a single 90-day extension of the 120-day period for 90 days, not the lessor.

Section 405

Section 405 amends Code § 1102(b) to require that official committees "provide access to information" to creditors not serving on the committee. Although apparently intended to enhance the dissemination of information to, and participation in the reorganization process by, all creditors, the amendment is troubling and will likely produce unintended results.

The amendment fails to appreciate important differences between creditors that are members of the committee and those that are not. Members of a committee are charged with a fiduciary duty that ordinary creditors do not have. This duty prevents committee members from engaging in self-dealing or otherwise taking action in a case for personal benefit rather than for the benefit of the estate and the committee's creditor constituents. Creditors not serving on the committee are under no similar duty and are generally free to pursue their own interests without regard to other creditors, the estate or even the collectively beneficial goal of rehabilitating the debtor.

In addition, Section 405 will ultimately serve to decrease the amount of information available to all creditors, including the committee members, because it does not take into account the sensitivity of the information to be released, particularly in the public company context. Concerns over confidentiality could easily lead debtors to resist sharing information, even with the committee, which will not only increase costs as the parties litigate the issue of disclosure, but will decrease the likelihood of a cooperative effort between the debtor and the committee toward a plan of reorganization.

The CLLA believes that any benefit to be derived from this amendment is far outweighed by the harm that it will likely produce and it should be repealed. Should Congress disagree, the CLLA suggests, as a further amendment, a mechanism that would allow the committee to move the court for an order relieving the committee from the requirements of this Section in appropriate circumstances or conditioning compliance as necessary to protect the interests of the parties and the integrity of the process.

COMMERCIAL LAW LEAGUE OF AMERICA®

Section 417

Section 417 amends Code § 366 to provide a different standard for adequate assurance of payment to utilities in Chapter 11 cases than in cases filed under any other chapter of the Code. The language used to effectuate this change, however, requires modification.

Section 417 links the required assurance of payment to the date of the petition, rather than to the date of the order for relief, as does the unamended Code § 366(b). As such, the amendment applies to involuntary cases, even where the merits of the petition are subject to dispute. Given Congressional treatment of involuntary petitions, especially those filed in bad faith, in other provisions of the Act, the CLLA believes the reference to "petition" rather than "order for relief" to be the result of oversight.

In addition, Section 417 is internally inconsistent. It amends Code § 366(c)(2) to allow a utility to terminate service if, after 30 days from the petition date, the debtor or trustee does not provide adequate assurance of payment "that is satisfactory to the utility." This seemingly unfettered discretion, however, is difficult to reconcile with the remainder of the Section, which expressly defines "assurance of payment" as including specific forms of security or another form to which the utility and the trustee or debtor mutually agree, and, additionally, permits the court to modify the amount of the assurance of payment.

The CLLA recommends that the "is satisfactory to the utility" language be stricken from Code § 366(c)(2) and replaced with "meets the requirements of paragraph (1)" or similar language.

Section 419

The last reference to "debtor" in the final sentence of subsection (b) to Section 419 should be amended to add the word "the" prior to "debtor."

Section 434

Section 434 creates a new Code § 308. For clarification, the references to "(A)(i)" in (b)(4)(B) should be "4(A)(i)" to insure the reader understands the subsection intended.

Subparagraphs (B) and (C) of § 308(b)(4) should be re-designated as paragraphs (5) and (6) of § 308(b) because their current designation appears to be a drafting error based on the grammar and substantive content of those provisions.

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

COMMERCIAL LAW LEAGUE OF AMERICA®

Section 442

Section 442 amends Code § 1112 regarding conversion or dismissal of a chapter 11 case, but the amendment appears to deprive the United States trustee or bankruptcy administrator from seeking this remedy. Code § 1112(b), as amended, states that is it only upon the request "of a party in interest," and not by the United States Trustee or a bankruptcy administrator, that conversion or dismissal may be sought. This would preclude, under the plain meaning doctrine, the right of the United States Trustee or a bankruptcy administrator to bring the motion. The CLLA believes Congress did not intend this result, particularly in light of the amendment to 28 U.S.C. § 586, which obligates the United States Trustee to move for conversion or dismissal under certain circumstances. Read together, these two provisions would impose upon the United States Trustee a statutory duty to seek conversion or dismissal, but would preclude the motion under § 1112.

Paragraphs (1) and (2) of subsection (b) both use the phrase "absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate." This is problematic not only because it creates a redundancy, but also because presence of the phrase in paragraph (2) makes no sense, as it suggests that evidence of harm to creditors and the estate resulting from dismissal or conversion is a condition for *granting* the motion. In order to resolve the problem and lend much needed clarity to subsection (b), the CLLA suggests the "unusual circumstances" language be stricken from paragraph (2).

As now written, the lead in paragraph in Code § 1104 states that the court has the authority to appoint a trustee, but not an examiner, but the more specific subsection allows the court to appoint either a trustee or an examiner. Code § 1104(a)(3) should be amended to exclude the words "or examiner" or alternatively, the lead-in clause in § 1104(a) should include the words "or examiner" to make the provisions parallel.

Section 446

Section 446 amends Code § 521 requiring a debtor to fulfill the duties of an ERISA plan administrator if the debtor or an entity designated by the debtor, served as such administrator as of the petition date. As written, however, the new statute seems to require the debtor to assume the duties it had previously delegated. The CLLA suggests a further amendment to clarify that the debtor may continue to designate an entity to serve as plan administrator.

Section 601

Section 601 creates a new 28 U.S.C. § 159 regarding bankruptcy statistics. Subsection (c)(3)(G) should be clarified to remove the concept of "'fined" from the evaluation of misconduct, as not all misconduct is subject to a "fine." Further, this review should include not only creditor

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

CLLA™
COMMERCIAL LAW LEAGUE OF AMERICA®

misconduct, but misconduct by debtors as well. Similarly, subsection (c)(3)(H) should be expanded to include not only Rule 9011 of the Federal Rules of Bankruptcy Procedure sanctions against debtors' counsel, but also against creditors' counsel.

Section 1201

Paragraph (3) of Section 1201 incorrectly inserts paragraph (23) and (35) into Code § 101 (35)(B) replacing paragraphs (21B) and (33)(A), respectively. This is incorrect. There should be no change and the references to paragraph (21B) and paragraph (33)(A) should remain.

Section 1221

Subsections (d) and (e) of Section 1221 do not amend the Code but contain general propositions for applicability and rules of construction with respect to various provisions relating to non-profit charitable corporations in bankruptcy. These additional provisions should not be placed into the Code.

Section 1224

If Congress intends to create an exception to discharge in cases under Chapter 13 for certain trustee expenses, it should make an appropriate amendment to §§ 523 and 1328 of the Code.

Section 1228

Section 1228 contains requirements for producing tax documentation in Chapter 7, 11 and 13 bankruptcy cases, but without specifically amending the Code. It is unclear where these provisions should be placed in the Code. As a possible alternative, these requirements could become part of the United States Trustee's Guidelines.

Section 1233

The provisions in Section 1233 related to direct appeal are confusing regarding how certification is achieved with respect to 28 USC § 158(d)(2)(A) and 28 USC § 158 (d)(2)(B). The proposed change below to §158(d)(2)(A) clarifies the confusion by providing for certification if all the appellants and appellees stipulate (without a court determination) to certify the matter to the court of appeal for authorization.

> (d)(1) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section.
>
> (2)(A) The appropriate court of appeals shall have jurisdiction of appeals described in the first sentence of subsection (a) if the bankruptcy court, the district court, or the

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order, or decree described in such first sentence, or (b) all the appellants and appellees (if any) acting jointly, certify that –

(i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance;

(ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;

and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel –

(i) on its own motion or on the request of a party, determines that a circumstance specified in clause (i), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);

then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

COMMERCIAL LAW LEAGUE OF AMERICA®

Conclusion

The CLLA and its Bankruptcy Section appreciate your consideration of the concerns expressed herein. We would be happy to respond to any additional inquiries or concerns that you may have with respect to achieving meaningful bankruptcy reform legislation.

Respectfully submitted,

Jerry T. Myers
President
Commercial Law League of America

Cathy S. Pike
Chair, Bankruptcy Section
Commercial Law League of America

Randy T. Slovin
Co-Chair, Governmental Affairs Committee
Commercial Law League of America

Peter C. Califano
Co-Chair, Governmental Affairs Committee
Chair Legislative Committee
Bankruptcy Section
Commercial Law League of America

Catherine E. Vance
Co-Chair, Sub-Committee on BAPCPA
Bankruptcy Section
Commercial Law League of America

Jay L Welford
Co-Chair, Sub-Committee on BAPCPA
Bankruptcy Section
Commercial Law League of America

70 East Lake Street, Suite 630 ▪ Chicago, IL 60601
Phone: 312.781.2000 Fax: 312.781.2010 info@clla.org www.clla.org

Statement for the Record by the
Credit Union National Association on the
December 6, 2006 Hearing on
"Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act"

The Credit Union National Association (CUNA) appreciates the opportunity to submit this statement for the record to the Senate Judiciary Committee's Subcommittee on Administrative Oversight and the Courts. The subcommittee has conducted a hearing to review the experiences of courts, trustees, creditors, debtors and counseling agencies with the provisions of the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," which has been in effect for fourteen months. CUNA represents about 90% of the nation's almost 9,000 credit unions, which are not-for-profit, member-owned financial cooperatives. Bankruptcy reform was a major legislative priority for the credit union movement for over a decade. CUNA was pleased to see that the bankruptcy bill which emerged from Congress in 2005 was supported by large, bi-partisan votes.

As Chairman Sessions noted during the hearing last week, it took eight years, 30 hearings and a dozen votes by the House and Senate to pass amendments to the bankruptcy law. The bill that was signed into law by President Bush in April 2005 was not perfect from anyone's perspective. As is true with any comprehensive piece of legislation, provisions addressed a wide range of problems and concerns raised by a wide range of participants in the bankruptcy process. The December 6th oversight hearing demonstrated that the debate will continue as to whether the 2005 amendments fairly balanced the needs and rights of creditors and debtors.

CUNA strongly feels that it is way too soon to even begin to assess what, if any, changes are needed in the new bankruptcy law. While it may be interesting to speculate as to the meaning of the data on bankruptcy filings since the effective date of the law, the unprecedented number of bankruptcy filings in the weeks prior to October 17, 2005 makes the subsequent data difficult to interpret. Title XIII on additional consumer credit disclosure has yet to be implemented by the Federal Reserve Board.

CUNA was particular impressed by the December 6th testimony of Clifford White III, the director of the Executive Office for the United States Trustees (EOUST), which is part of the Department of Justice. The U.S. Trustee Program has shown its commitment to carry out the significant additional responsibilities assigned to it by the 2005 amendments. Mr. White testified that "the reforms have been workable and show promising signs for positive results in the future." He added that the 2005 law "provides new tools for the Program to combat bankruptcy fraud and abuse."

During the decade that CUNA worked with members of Congress to pass meaningful bankruptcy reform, we made it clear that there were several specific provisions needed in order to assure credit unions' support. These provisions included:

- **The "means test"**: CUNA supported the "substantial abuse" test when it was added to the bankruptcy law in 1984, but that standard failed to adequately address abuses in the bankruptcy process. The "means test" incorporated into the 2005 law allows trustees, judges, creditors, debtors and their attorneys to better ascertain if a debtor should have to try to pay off some of his unsecured debts in Chapter 13, rather than having most of those debts wiped out in Chapter 7. As Mr. White noted in his testimony, "In many ways, means testing is the cornerstone of the new bankruptcy reform law." He goes on to suggest two preliminary conclusions: The means test is workable; and the means test provides a promising approach to identifying abuse.

  CUNA has consistently said that most people who file for bankruptcy need Chapter 7 relief because they have been forced into bankruptcy because of job loss, medical bills, or divorce. We testified prior to the passage of the bankruptcy reform amendments that we think less than 10% of the people who are above the median income and file for bankruptcy will be affected by the means test. As people who are considering bankruptcy – and their lawyers – apply the means test to their particular financial circumstances, the number of people who are actually shifted from Chapter 7 to Chapter 13 after their initial filing will undoubtedly be very low because debtors will already know whether their circumstances and their means test calculation will even support a Chapter 7, rather than a Chapter 13, filing.

  With the means test, there is a presumption – but a rebuttable presumption -- that abuse exists if the debtor files for Chapter 7 relief and, with the application of the means test, the debtor's income exceeds his expenses by a certain amount. The law allows the debtor to demonstrate to the court special circumstances that justify additional expenses or an adjustment of the income calculation. We believe this provision provides the court with adequate discretion to look beyond the means test formula and provide Chapter 7 relief if warranted. CUNA supported the provision in the 2005 law which requires the EOUST to issue a study in the spring of 2007 on the adequacy of the IRS expense calculations and the impact that the use of such standards has had on debtors and the bankruptcy courts.

- **Mandatory financial education:** Two other provisions essential to the credit union movement in any bankruptcy reform legislation were the requirements that individuals must receive credit counseling prior to filing for bankruptcy and debtors must take a personal financial management course prior to discharge. Mr. White observed in his testimony that "these are potentially the most far-reaching consumer protection provisions in the Bankruptcy Code. These requirements are designed to ensure that debtors enter bankruptcy knowing what their options are and exit bankruptcy with the tools to avoid future financial catastrophe."

  Many credit unions have been very involved in financial counseling services for years. A creditor wants to work with a consumer/borrower much earlier than when he is so overwhelmed that he is on the verge of filing for bankruptcy. A credit union typically will not qualify as an independent organization to provide the mandatory pre-filing credit counseling because it cannot counsel its own borrower who later files for bankruptcy. CUNA is adamantly opposed to any connection between debtors' attorneys and the required credit counseling and educational pre-discharge programs, since we feel a connection would make these requirements merely *pro forma* and undermine their benefits.

As Mr. White noted, right now there appears to be an adequate number of educational outlets available for debtors. We will have to see what steps are necessary to assure adequate credit counselors and debtor educators as bankruptcy filings pick up in coming years. Eventually, credit unions may want to apply to offer formally approved pre-discharge educational programs, and they should qualify to do so.

These bankruptcy educational provisions are one part of the much bigger picture of financial literacy. One witness complained last week about the burden put on people who are filing for bankruptcy of having to collect tax records, payroll slips and other documents. CUNA is committed to incorporating financial education into our schools. Children, teenagers and adults need to be thoroughly educated in preparing budgets, handling credit responsibly, and maintaining the necessary paperwork. Credit unions specifically supported the requirements on improved documentation, not only so trustees can examine the information provided but also so that creditors can see if fraud was potentially committed when the person applied for credit.

- **Reaffirmations:** CUNA was strongly committed during the consideration of bankruptcy reform legislation to protecting the ability of credit union members to voluntarily reaffirm their debts with their credit unions. Although some people question why anyone would ever agree to a new contract which requires continuing payments on a debt which could be erased in bankruptcy, reaffirmation with a trusted lender allows the individual declaring bankruptcy to continue, for instance, to drive his car with a reasonable loan interest rate or to receive credit on non-predatory lending terms. The 2005 law requires detailed "Truth-in-Lending-like" consumer disclosures about what a reaffirmation covers and what it means. We have received surprisingly little feedback at this point about burdens with the new reaffirmation requirements once the new reaffirmation forms were made available.

CUNA believes that it is essential that the new law be implemented as written and consistently followed throughout the country. The new law's rules on valuation of collateral, the lifting of the automatic stay, and the debtor's declaration and action on redeeming, reaffirming or returning collateral involving such debts as automobile loans are very important to credit unions. After all, money that a credit union loses through a member's bankruptcy is a loss that impacts all members in the credit union because of its cooperative structure.

In conclusion, CUNA is confident that the vast majority of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 will prove to be good law. Undoubtedly, a few of the detailed procedures spelled out in the 2005 amendments may eventually need to be changed as debtors, creditors, courts and attorneys live with the new law. We hope that the 110th Congress will decide that it is too soon to revisit a law so long in the making and so short in the practice.

We thank the Subcommittee for the opportunity to submit this statement for the record.

UNITED STATES SENATOR • IOWA

CHUCK GRASSLEY

http://grassley.senate.gov
grassley_press@grassley.senate.gov

Contact: Jill Kozeny, 202/224-1308
Beth Levine, 202/224-6197
Lucas Bolar, 202/224-0484

Prepared Statement of Senator Chuck Grassley of Iowa
Senate Committee on the Judiciary, Administrative Oversight and the Courts Subcommittee
Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act
Wednesday, December 6, 2006

Chairman Sessions, I'm pleased that the Subcommittee is holding this hearing on the implementation of Public Law 109-8, the bankruptcy reform legislation. The Chairman's leadership helped make this commonsense reform a reality after many years of hard work. And I thank him for his continued efforts to make sure that our bankruptcy system is working as it should.

As the Chairman well knows, this law was the result of more than a decade of comprehensive study and intense debate in Congress. Whatever criticisms one may have about the legislation, everyone has to acknowledge that it was thoroughly vetted and debated here in Congress. There was a lot of compromise on both sides. And in the end, large bi-partisan majorities - Republicans and Democrats together - voted to enact bankruptcy reform.

Why so much support for bankruptcy reform? The majority of Americans knew that the bankruptcy system was broken and needed to be improved. My office received many letters and calls over the years complaining about bankruptcy abuse and unfairness with the system.

The central premise of bankruptcy reform – that if an individual wants to file for bankruptcy and can repay some of his debt, he should do just that, pay a portion of that debt - is supported by almost everyone. That's because it's fair to ask debtors who can repay to do so.

As I've said many times before, we needed to restore balance to a bankruptcy process that had become too easy, where clever lawyers gamed the integrity of the bankruptcy system for the benefit of individuals who wanted to get out of their debts scott-free and to the detriment of people who played by the rules. That's why bankruptcy rates in the 1990's and early 2000 timeframe exceeded bankruptcy rates during the Great Depression, despite the fact that the economy was going strong during much of that time period.

With the new bankruptcy law, Congress closed some loopholes and enacted some important consumer protection provisions so folks could be more knowledgeable about their finances. The new bankruptcy law created a means test in order to retain Chapter 7 bankruptcy for those who truly were in need of that relief, and to require those who could repay a portion of their debts to pay that debt to their creditors. The law injected more integrity and fairness in the bankruptcy system.

So how has the new bankruptcy law worked so far? Early reports indicate that it has been working well. We've seen bankruptcy rates fall dramatically. From about 2 million bankruptcies in 2005, to the point where there probably won't be more than one million bankruptcies in 2006, if current trends continue. In my mind, fewer bankruptcy filings are bound to boost the American economy.

Why do I come to this conclusion? When considering the effect of bankruptcy on the economy, I often recall Clinton Administration Treasury Secretary Larry Summers telling us that high levels of bankruptcies tend to push up interest rates. So, lowering bankruptcy rates will reduce the upward pressure on our economy. Based merely on these decreased filing rates, I think that it's fair to say that bankruptcy reform has been a success for our economy.

Earlier this year, I stated on the Senate floor that the numbers indicated that bankruptcy reform has saved our economy around $60 billion. That's a substantial savings for our economy. That's around $60 billion that would have been lost, that would have been a drag on our economy. And I'm confident that at least some of that money has been or will be re-directed to economic growth and American jobs.

It's also important to remember that there were a number of consumer protections included in the new bankruptcy law. Let me mention some of them. Retirement savings are now generally protected from the reach of creditors. Education savings are also generally protected. And lenders who won't compromise with financially-troubled borrowers can be penalized for not negotiating out-of-court settlements.

People considering filing for bankruptcy have access to no cost or low cost credit counseling and financial education. We want people who make bad financial choices to learn how to deal with their finances and quit the spending cycle. After all, better educated consumers are a benefit to everyone. The law even encourages education of young people on how to handle their finances. And credit card companies are required by the new law to warn consumers about the dangers of making only minimum payments, as well as clearly identify payment amounts.

But there are challenges. The powerful special interests here in Washington that opposed bankruptcy reform have not gone away. They're still trying to undermine these commonsense reforms by filing lawsuits challenging these reforms and by supporting regulations that water down the law. For example, the federal courts produced a bankruptcy form that is supposed to measure repayment ability. But it's my understanding that this form actually directs consumers to claim deductions for expenses a debtor may not even have. That certainly wasn't the intent of the law. The form legitimizes gaming of the law, reduces the integrity of the system, and ultimately undermines the reforms we were trying to accomplish.

Moreover, everyone who has followed this issue for any length of time will recall how the Federal Trade Commission had to issue a public warning over sleazy business practices by bankruptcy mills. Congress responded to this by enacting some dramatic consumer protections. For example, under the new law, attorneys must disclose their fees to their clients. They must disclose the down sides of bankruptcy. And they must not counsel anyone to commit fraud by running up debt on the eve of bankruptcy.

But how has the bankruptcy bar responded? You'd think by cleaning up their act, and by increasing professionalism? Unfortunately that isn't the case. The bar has responded to our attempt to help consumers by seeking to declare these consumer protections unconstitutional. In fact, right now in a Connecticut court, consumer bankruptcy lawyers are trying to convince a federal judge that they have a right to advise people to commit fraud by telling consumers to run up debts they have no intention of ever repaying. Right now, these lawyers are trying to get out of disclosing to their clients what their fees are.

No wonder even the American Bar Association has acknowledged that there is a real need for special disciplinary rules for consumer bankruptcy lawyers. And there's growing evidence that consumer bankruptcy lawyers are trying to deny consumers access to valuable credit counseling by trying to buy off the counselors. Just recently, I joined Chairman Sessions in a letter to the Justice Department asking about one counseling agency that actually solicited business by promising not to advise consumers about alternatives to bankruptcy.

The Department of Justice has done an admirable job of defending the law. But they shouldn't have to use precious time and resources defending needed consumer protections.
They should be free to use their resources to protect consumers directly.

In addition, I've seen more than one instance of bankruptcy judges criticizing the new law in very inappropriate ways. This is extremely disappointing. This does not comport with my understanding of proper judicial behavior.

Of course, any judge should be free to exercise his or her judgment about how to interpret the new law, and I certainly would never want to infringe on the core work of a judge. But when judges give press interviews and call the new law 'garbage" or question Congress' motives for passing bankruptcy reform during a court hearing, I think a clear line has been passed. Congress writes the laws; judges are supposed to interpret and apply the laws in an impartial manner. The bottom line is Congress passed bankruptcy reform by a wide margin with both Republicans and Democrats supporting it. The President signed it into law.

That's how the American legal system is supposed to work. We have a democracy. Unelected federal judges don't get to substitute their own personal policy preferences for the considered decisions of the elected branches.

But that doesn't appear to matter to some bankruptcy judges who have decided they know better than everyone else how this country ought to be run.

That's why I intend to write a letter to Chief Justice Roberts asking him whether this conduct violates the ethical rules for judges. Judges are supposed to be neutral. They are supposed to understand their role in our system of government. I hope that Chairman Sessions will join me in looking into this matter and will sign onto my letter to the Chief Justice asking him to look into this conduct, which I believe is unacceptable.

All in all, Mr. Chairman, I think that the new law is working well. We need to be vigilant here in Congress as the law is implemented, and to make sure that people who don't want to follow the law's mandates and good reforms are not undermining the law or integrity of the bankruptcy system, or shirking their responsibilities to enforce the law. So, I'll keep a watchful eye on developments in the future. Again, thank you Chairman Sessions for your leadership on this issue and for holding this oversight hearing.

Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
Washington, D.C.

"Oversight of the Implementation of the Bankruptcy Abuse Prevention Act"

Wednesday, December 6, 2006
2:30 p.m.

Testimony of
Henry E. Hildebrand, III
Standing Chapter 13 Trustee for
The Middle District of Tennessee
and
Chair, Legislative and Legal Affairs
Committee of the
National Association of Chapter 13 Trustees

Mr. Chairman, members of the Sub-Committee, distinguished witnesses, I am delighted to have the opportunity to meet with you today to discuss a topic that has been the focus of my professional life for the last eighteen months, the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. As a chapter 13 trustee for the past 25 years, and as the Chair of the Legislative and Legal Affairs Committee of the National Association of Chapter Thirteen Trustees, I have been observing the genesis of this law with great interest and concern since its birth in 1997, its eight year evolution and finally the end result as a bill signed into law on April 20, 2005. Since it's effective date on October 17, 2005, my colleagues and I have struggled to comply with its provisions, attempted to discern your intent, uncover its meaning and comply with the obligations that it places on us and others.

I appear today as the representative of the National Association of Chapter Thirteen Trustees, (NACTT) a national organization created to further the education of the consumer bankruptcy practitioner, to provide assistance and support to decision makers and the courts, and to impart the highest of professional standards to all of our members.

The NACTT is not simply a trustee organization. While virtually all of the standing trustees in the country are members of the NACTT, so too are national and local creditors, bankers, finance companies, and health service managers. Our membership also includes a significant number of debtors' attorneys and consumer advocates. As both a trustee organization and as a multi-faceted bankruptcy organization, the NACTT has worked hard to be broad based in its approach on recommendations for legislation and improvements to the bankruptcy process. The suggestions that we made as Congress crafted the BAPCPA were presented, not with the intention of altering basic policy decisions of Congress, but in recognition of the practical impact the legislation would have on the day to day administration of consumer bankruptcy across the United States. We met with staff members of this Committee, not to advocate for one group or another, but to counsel caution in the actual drafting of the law. Now is an appropriate time for us to look back on the past fourteen months and see where we have landed.

From the moment that the President signed BAPCPA into law, we have worked diligently and tirelessly to educate trustees and members of the bankruptcy bar on the provisions of the new law. We created more than 10 hours of educational DVDs for dissemination across the country regarding the impact of the new law on trustees, debtors, creditors and the court. Our members hosted seminars and training sessions, some large, some small, but all focused on getting the entire system prepared for the dramatic changes BAPCPA would bring. Our members were directly involved in presenting educational programs which reached, by our count, more than 10,000 practitioners and their staffs. We were expected to create new forms, rewrite our software, retrain our employees, and assist in the development of new rules and procedures. We did so with professionalism and commitment.

We were not without assistance in our efforts. Working directly with the dedicated professionals of the United States Trustee Program, we sought to develop consistent national positions on matters that would inevitably become part of the new paradigm of consumer practice. The leaders in the USTP worked with us as we retrained, retooled, rebudgeted and restaffed in an effort to meet the challenges of the new law. The USTP helped us establish the means to provide financial management education programs for debtors in cases we administer. Each month the number of debtors we educate is growing. In many ways, our work with this agency has never been more important or more mutually supportive than in the past eighteen months.

As we look back on the last eighteen months, we must face some stark truths about the new law; recognize that some of our worst fears as "in-the-trenches" participants in the process did not materialize but also recognize that some significant problems have developed as a result of the new law. We think that it is appropriate to look to you for guidance and assistance.

We believe Congress intended the trustee play a greater and more significant role in maintaining the integrity of the system.[1] We also believe that the goal of encouraging or compelling debtors who "can pay" to pay more was not met, largely through cumbersome drafting or misguided attempts to standardize the process. The language used by the crafters of BAPCPA has, in many ways, resulted in unexpected outcomes and unintended consequences.

We believe that the language used to present a new national policy on bankruptcy and the forgiveness of debt was confusing, needlessly complex, and inconsistent. Problematic language has led to inconsistent judicial interpretations of the new law. We have been forced, as trustees, to struggle against our long standing desire to increase payments to general unsecured creditors when we are faced with Congressional language that compels a contrary result. The confusion in the text of the law has resulted in debtors and creditors, in similar situations, being treated differently depending upon where the bankruptcy is filed. As a group, we ask this committee to take a look at some of the very difficult language used to articulate this policy and correct those drafting errors where possible.

[1] For example, BAPCPA requires the debtor to submit to the chapter 13 Trustee copies of the debtor's tax returns (§521(e)(2)); the Trustee is required to provide notices to holders of Domestic Support Obligations and State child support enforcement agencies of the filing and the discharge (§1302(d)); the Trustee must verify if the debtor has made preconfirmation adequate protection payments and, if so, how much was paid (§1326(a)(1)(C)); the Trustee is expected to review debtors' financial conditions annually during the pendency of a chapter 13 case (§521(f)(4)).

EXAMPLES OF DRAFTING ISSUES AFFECTING CHAPTER 13

Congress wanted debtors who file bankruptcy to receive a prepetition briefing outlining the opportunities for credit counseling.[2] Clearly it was contemplated that the briefing would take place prior to the filing of the petition, but the language requiring this is not totally clear: ("...during the 180-day period preceding the date of filing of the petition...") Was it Congress' intent that the briefing take place before the filing or at least on full day prior to the filing?[3]

If a debtor files a chapter 13 petition without having obtained a prepetition briefing and thus having failed to satisfy the requirements of §109(h), has a petition been filed?[4]

Congress intended that debtors provide to the court information necessary to administer the case. To compel compliance, § 521(i) provides that a debtor's

---

[2] Congress indicated that what debtors must have is a "briefing". Common parlance has referred to this as "credit counseling" and the implementation of §109(h) has supported the common parlance. See *In re Hawkins*, 340 B.R. 642 (Bankr. D.D.C. 2006)("Congress did not explain what it meant by 'available credit counseling' and 'a related budget analysis' . . . leaving the court to guess as to what must be addressed specifically in a credit counseling session . . .")

[3] Compare *In re Mills*, 341 B.R. 106 (Bankr. D.D.C. 2006) (Because of the language of the statute, the briefing must occur at least one calendar day prior to the filing.) with *In re Warren*, 339 B.R. 475 (Bankr. E.D. Ark. 2006) (A briefing must simply occur prior to the actual time of filing, even if the briefing occurred on the same day as the filing.)

[4] Compare *In re Ross*, 338 B.R. 134 (Bankr. N.D. Ga. 2006) (The filing of a petition by a debtor having failed to satisfy the briefing requirement was the filing of case which gave jurisdiction to the court to dismiss the case.) with *In re Salazar*, 339 B.R. 622 (Bankr. S.D. Tex. 2006 (The filing of a petition by a debtor having failed to satisfy the briefing requirement did not file a case and the petition would be struck.).

failure to file all of the information[5] required will result in an automatic dismissal. If a case is "automatically" dismissed, is there any necessity for a court order? If, after a plan is confirmed, it comes to light that a debtor did not file all of the information required in § 521(a)(1), what is the effect of § 521(e) on a trustee's distributions after the 46th day?[6]

We think it clear that Congress intended to deprive debtors filing a second or third petition within a year of the dismissal of a previous case with the same type of relief as that provided to first time debtors. The language used to effect a limit on second time filers in §362(c)(3) is confusing and inconsistent with the parallel provision dealing with third time filers in the following subsection. Was it Congress' intent to limit the extent of the termination of the stay as indicated in the statute?[7]

Chapter 13 was amended to prevent the "cramdown" of a purchase money security interest in a motor vehicle incurred within 910 days of the filing of the petition. While this has the confusing effect of diverting funds formerly available to unsecured creditors to the "unsecured" portion of an auto lender's

---

[5] It is interesting and confusing to note that the statute does not apply if a debtor fails to file the required document; the statute applies if the debtor fails to file "the information."

[6] See, *e.g.*, *In re Riddle*, 344 B.R. 702 (Bankr. S.D. Fla. 2006).

[7] Compare *In re Jupiter*, 344 B.R. 754 (Bankr. D. S.C. 2006) and *In re Jumpp*, 334 B.R. 21 (Bankr, D. Mass. 2006) (When the stay terminates for a repeat filer, the entire stay terminates) with *In re Moon*, 339 B.R. 668 (Bankr. N.D. Ohio 2006) and *In re Jones*, 339 B.R. 360 (Bankr. E.D.N.C. 2006) (When the stay terminates for a repeat filer, the stay only terminates "as to the debtor" and the debtors' property, not as to property of the estate.)

claim, it appears that, as a matter of policy, Congress has determined that auto lenders are to be preferred over medical care providers, hospitals, local vendors, and older taxes. In doing so, the drafters created a "hanging sentence" at the end of §1325(a)[8]. The strict application of the language in this "hanging sentence" has led some courts to conclude that Congress intended to require a debtor to either pay the claim in full or to surrender the motor vehicle collateral in full satisfaction of the claim.[9] Reading the exact same language, other courts have concluded to the contrary.

In a clumsy effort to place an objective test to determine a chapter 13 debtor's disposable income, Congress grafted the "means test" (the method used to determine if a debtor has filed an abusive chapter 7 petition), in the "disposable income test" of §1325(b). We had previously counseled caution in this approach and it appears that our concerns were well founded. The confusing language of § 1325(b) has led to a vast divergence of opinion on how the "disposable income test" is supposed to work. Some courts have concluded that if a debtor's plan proposes to pay to the unsecured creditors what the "means test" proposes, a debtor is free to do so, even if the debtor has actual

---

[8] Courts have had a difficult time in dealing with this provision, in part because it is almost impossible to cite. It has been referred to as the "hanging paragraph" or §1325(a)(*) by some courts.

[9] Compare *In re Brown,* 346 B.R. 868 (Bankr. N.D. Fla. 2006) and *In re Gentry,* 2006 WL 3392947 (Bankr. E.D. Tenn. Nov. 22, 2006) (Because the statute provides that §506 does not apply to 910 car claims, there is no basis for there to be an unsecured portion of the claim when the debtor elects to surrender the collateral, thus the collateral can be surrendered in full satisfaction of the claim) with *In re Zehrung,* 351 B.R. 675 (W.D. Wisc. 2006) and *In re Duke,* 345 B.R. 806 (Bankr. W.D. Ky.) (It could not have been Congress' intent to preclude a creditor secured by a 910 car claim from asserting a deficiency when the debtor elects to surrender the collateral to the creditor.

income that demonstrates he or she is capable of paying more to creditors.[10] Other courts have felt that Congress' definition of "disposable income" is not the same as "projected disposable income", freeing the court from reliance upon the "means test" requirements.[11] This cornerstone of chapter 13 is now inconsistently applied, jeopardizing the equitable and fair nature of chapter 13.

GIVE TRUSTEES THE TOOLS TO ACCOMPLISH THEIR TASKS

Trustees are expected to keep the system honest, to monitor the performance of debtors in their plans, to review pay advices, tax returns and annual budgets, and to seek modifications when appropriate. Also, trustees must review plans which may have four different disclosures of a debtor's income for every case filed.[12] Trustees are involved in virtually all of the cases that are interpreting the new law, and are involved in most of the appeals. Trustees must have educated staff, with adequate training to review tax returns and seek modification of plans.

The new law has resulted in some decline in filings across the country creating additional challenges to trustees in dealing with limited resources.

---

[10] See, for example, *In re Quarterman*, 342 B.R. 647 (Bankr. M.D. Fla. 2006) and *In re Alexander*, 344 B.R. 742 (Bankr. E.D.N.C. 2006). Note that "Current Monthly Income" as defined has virtually no relationship or connection to what a debtor is actually earning or can afford to pay.

[11] See, for example, *In re Grady*, 343 B.R. 747 (Bankr. N.D. Ga. 2006) and *In re Kibbe*, 342 B.R. 411 (Bankr. D.N.H. 2006)

[12] Debtors must disclose their Current Monthly Income, their income and expenses, their net monthly income and their projected future income. How these different amounts are to impact upon a chapter 13 plan is unclear.

Reductions in caseload is manageable, but now debtors have repeatedly proposed to make payments directly to secured creditors, seeking to avoid the trustee's commission on such payments.[13] Even though the tasks to be performed by the trustee (including the extensive monitoring of the case and the notification of Domestic Support Obligation claimholders) are the same, if the law permits a debtor to avoid the costs of the system, trustees will not have the ability to meet the expectations of Congress in enacting BAPCPA.[14] The services of a chapter 13 Trustee are more than that of a mere disbursing agent, and the impact of BAPCPA confirms this.[15] To fulfill congressional expectations, and to make the system work, the Chapter 13 Trustees suggest that Congress make clear that, absent some compelling justification other than avoiding the cost of administration, the trustee is to make all of the distributions under a confirmed chapter 13 plan.

The new law has created new challenges, new problems, and requires new skills. The NACTT is committed to meeting these challenges and implement the new law as outlined by Congress. We encourage you to examine the confusing and inconsistent provisions of the law with an eye towards assisting courts and practitioners in meeting the obligations under the law. We pledge to work with you as you do so.

[13] Pursuant to 28 U.S.C. §586(e) the commission of the chapter 13 Trustee is determined by the "payments received by such individual under plans..." If the trustee is not receiving the payments, then the trustee is not entitled to the commission.
[14] See, e.g. *In re Lopez,* 350 B.R. 868 (Bankr. C.D. Calif. 2006); *In re Clay,* 339 B.R. 784 (Bankr. Utah 2006); *In re Vigil,* 344 B.R. 624 (Bankr. D. N.M. 2006) (Statute specifically permits confirmation of plans where debtors make direct payments to creditors to avoid the trustee's commission).
[15] See, *In re Perez,* 339 B.R. 385 (Bankr. S.D. Tex. 2006) (Court outlines all of the practical benefits of a local rule that requires the chapter 13 Trustee to make disbursements under a plan).

SUBMISSION OF DAVID C. JONES
PRESIDENT, ASSOCIATION OF INDEPENDENT CONSUMER CREDIT COUNSELING AGENCIES
Before The
UNITED STATES SENATE JUDICIARY COMMITTEE
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS
Hearing On The
ONE-YEAR ANNIVERSARY OF THE
BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT
December 6, 2006

Mr. Chairman and members of the Subcommittee, the Association of Independent Consumer Credit Counseling Agencies (AICCCA) appreciates the opportunity to address the current issues and future viability of the pre-bankruptcy credit counseling and pre-discharge financial education provisions of BAPCPA. AICCCA members currently provide counseling and education to millions of U.S. consumers and serve over 750,000 clients repaying their debts through legitimate Debt Management Plans. Together, these agencies annually return over $3.2 billion in consumer payments to the nation's creditors while providing consumers with a financial restructuring option outside of the bankruptcy system. In addition, we have counseled over 200,000 consumers entering the bankruptcy system since October of 2005.

AICCCA is pleased to provide input to the Subcommittee as it considers the effectiveness and future viability of pre-bankruptcy credit counseling, pre-discharge education. We commend Chairman Sessions for his authorship of these provisions, which seek to assure that debtors are fully informed of all their viable options for addressing financial distress before they file for bankruptcy, and that they emerge from the bankruptcy process with the basic education and budgeting tools that can minimize any future need for another bankruptcy filing. While we have some concerns about the process to date, we commend the Executive Office for US Trustees (EOUST) for its diligent attention to the implementation of these provisions and the Internal Revenue Service for its continued oversight of the credit counseling industry. We believe that consumers have benefited along with the nation's financial system.

The main points of my testimony are:

- There are more than adequate approved credit counseling agency resources available to provide pre-bankruptcy counseling at current filing levels but a focused effort would be advisable to assure that this remains the case as filings increase over time.
- Non-profit credit counseling agencies are currently providing pre-bankruptcy counseling at an overall financial loss and this situation must be addressed to help assure their continued voluntary participation; guidance from the EOUST regarding a clear standard for determining a debtor's ability to pay would be one welcome step toward that goal.
- The EOUST should also clarify what information credit counseling agencies may provide to debtors about the bankruptcy system without impermissibly providing

legal advice, and should also clarify permissible relationships between counseling agencies and debtor attorneys.

- The EOUST should not remove an agency from its approved list solely because its tax-exempt status is in question, and Congress needs to do more to assure that IRS field personnel are correctly implementing and communicating the current legal criteria for credit counseling agencies to achieve and retain Section 501(c)(3) tax-exempt status.
- The EOUST needs to provide guidance to assist in establishing debt settlement plans as a sanctioned non-bankruptcy alternative for those debtors who cannot fully fund a traditional debt management plan.

Our comprehensive comments further address these operational areas.

1. Bankruptcy Filing Levels and the Adequacy of Credit Counseling Resources

As you know, bankruptcy filings have undergone an extraordinary decline in 2006. According to information released by the Administrative Office of U.S. Courts on August 28th, filings in the second quarter of 2006 totaled 156,000, following up on first quarter filings of 117,000, for a total in the first half of 2006 of about 273,000. We do not have an explanation for the dramatic decline in filings, other than that we are certain that the necessity to obtain counseling from an approved Credit Counseling Agency (CCA) prior to filing and the modest cost of such counseling (waived or reduced for those debtors lacking ability to pay) cannot be a factor of any significance. Unless there is a very large increase in bankruptcy filings during the remainder of the year, total filings for 2006 are likely to be less than half of those for 2005, and could in fact be as many as one million cases less.

The present number of approved CCAs appears more than adequate to satisfy the need for pre-bankruptcy counseling at current filing levels. Even so, the credit counseling process demands a very personal approach with a distressed debtor. That process can only be effective when accomplished in a comprehensive face-to-face or telephone session. We do not believe that adequate counseling can be accomplished using the Internet alone. This consideration should be a major factor in the continuing implementation of BAPCPA and the EOUST's provider re-approval process.

We have serious concerns about the adequacy of counseling capacity should there be a significant upward spike in filings, especially if some currently approved agencies are not re-approved. A shortage of capacity in such circumstances could trigger the provisions of BAPCPA that provide for suspension of the counseling requirement in judicial districts lacking adequate capacity, and call into question the pre-bankruptcy counseling requirement unnecessarily. We believe strong efforts should be made to avoid such an outcome. Without some focused effort, there is a very real possibility that the number of participating CCAs will decline even as bankruptcy filings begin to accelerate.

2. The Need To Clarify "Ability To Pay"

Every CCA approved to provide pre-bankruptcy counseling must charge a "reasonable fee" for counseling services, must provide services "without regard to ability to pay that fee," and must provide to the EOUST its "criteria for providing services without a fee or at a reduced rate." AICCCA applauds these criteria, which are consistent with our own member accreditation standards.

Approved CCAs have, to date, been extremely cautious in assessing fees from debtors who claim they lack ability to pay. Yet approved CCAs have consistently been offering pre-bankruptcy counseling at a significant financial loss. All the information we have seen indicates that, for both AICCCA member and other approved agencies, the cost of providing a pre-bankruptcy counseling session in accord with EOUST criteria is about \$50, while the average payment for such a session is about \$32. Less than two percent of the present debtor population is even eligible to enter a Debt Management Plan (DMP), and many of those nonetheless choose to file bankruptcy. The opportunity so far for CCAs to offset the counseling loss with DMP income is negligible. This situation is simply not sustainable for non-profit entities that are already navigating severe fiscal constraints.

There are only two available remedies for this situation, absent external subsidy. The first is for the EOUST to clarify under what circumstances an approved CCA may refuse to provide counseling to an individual debtor, or refuse to provide a certificate of completion to a debtor who has received counseling, where the debtor's own financial information indicates that they indeed have an ability to pay a full or reduced fee. The second is to raise the average charge for a BAPCPA counseling session, which could well have the unfortunate result that some honest debtors would incur a higher fee to offset the refusal of another, perhaps better situated, debtor to pay the same fee.

Currently approved agencies will simply not be able to continue participation over the long term if the provision of BAPCPA counseling does not become at least a break-even financial proposition. This is especially true because the actual cost of completing an application to be an approved agency is, based upon feedback from AICCCA members, substantially more than the \$500 estimate provided by the EOUST in response to Executive Order 12866, and is accompanied by substantial additional costs for surety bonding as well as employee fidelity insurance.

3. The Question of What Constitutes Legal Advice

As noted earlier, bankruptcy filings have fallen by two-thirds compared to one year ago -- which means that the average debtor attorney is seeing two-thirds fewer prospective clients than one year ago. The debtor bar has made clear that it strongly opposed BAPCPA while it received Congressional consideration, and has already brought suit in multiple districts to seek judicial determination that its debt relief agency provision violates the Constitution.

The debtor bar has also made clear that it opposes, and resents, BAPCPA's pre-bankruptcy counseling requirement. While only about one percent of the current pre-bankruptcy counseled population is choosing an alternative to bankruptcy, it is quite possible that this percentage will grow significantly when bankruptcy filings increase and the debtor financial profile begins to include greater numbers of higher income debtors. AICCCA takes strong issue with the view of the debtor bar that the current low conversion rate of counseled debtors to a DMP or other alternative to bankruptcy should be taken as evidence that the requirement is not worthwhile. To the contrary, the large majority of individuals counseled by AICCCA member agencies have indicated that they found the budget analysis and other aspects of the counseling session to be quite useful. Indeed, we would urge Congress and the EOUST , as well as the lending community, to consider what steps could better encourage counseling to be undertaken sooner. If we were seeing financially troubled individuals before their problems had grown dire, and before they had consulted with and even paid a substantial retainer to a bankruptcy attorney, we would probably see greater use of the available alternatives to bankruptcy. We also expect that, as filing levels climb, a greater proportion of individuals with higher incomes will be considering bankruptcy and will find a DMP a viable option.

The debtor bar has made clear that it will respond to the perceived threat of credit counseling by a number of means. First, it will look for opportunities to allege that a particular approved CCA is "practicing law without a license" by providing basic bankruptcy information as part of the counseling process. Second, it will intervene in the counseling relationship by intrusively monitoring it. Third, it will press for repeal of the credit counseling requirement at the earliest political opportunity.

The EOUST already requires that approved CCAs..."shall not, unless otherwise authorized by law, provide legal advice on any matter." It would be extremely helpful to the credit counseling industry if the EOUST would delineate the boundaries of what advice can be provided by an approved CCA to a counseling client regarding the availability and consequences of bankruptcy without crossing the line to providing "legal advice." It would seem obvious that a counselor assisting a financially troubled debtor needs to be able to advise that individual that bankruptcy is one available option, that bankruptcy may offer either liquidation or partial repayment of debts depending on circumstances, and that a bankruptcy will remain on the credit report for a decade. These factual matters can be readily distinguished from the giving of advice regarding whether the debtor should file for bankruptcy, what Chapter of the Bankruptcy Code would be most advantageous and appropriate, and how the court would likely treat the bankruptcy petition.

BAPCPA's legislative history supports the view that Congress intended to ensure that debtors receive informed and objective advice from two separate sources -- an approved CCA and an attorney. Assuming that the EOUST addresses the proper pre-bankruptcy roles of attorneys and CCAs in the more comprehensive regulations it will propose later this year, we would urge it to clarify the legal and ethical boundaries for interaction between these two professions, particularly as regards the referral of clients to a particular agency and the collection of fees on behalf of that agency by a debtor attorney. EOUST oversight can help assure that attorney-agency relationship remains at arms' length, and that the counseling provided by each agency is comprehensive and meaningful.

4. Agency Removal

The EOUST has proposed that, in certain circumstances, its decision to revoke an agency's approved status need not wait upon an agency's exhaustion of its opportunity for administrative review but may be effected immediately by an interim directive. We hope that this short-circuiting of the administrative appeals process will be a rare exception, and take particularly strong exception to the EOUST's proposal that one factor supporting such an interim directive can be the revocation of the agency's tax-exempt status by the Internal Revenue Service.

BAPCPA is quite clear that, while non-profit status is required to become an approved CCA, tax-exempt status is not. Because tax-exempt status is not a statutory requirement, the EOUST should not deprive an approved CCA of its appeals right simply because it might lose or has lost that status. The EOUST already requires every approved CCA to complete and sign a tax waiver authorizing it to seek confidential information regarding the agency from the IRS, as well as to notify it immediately of the termination of that tax-exempt status by the IRS. Therefore, the EOUST already has access to any information developed by the IRS in the course of its audit of a particular agency. AICCCA believes that the EOUST should make its own independent judgment regarding a CCA's eligibility to provide pre-bankruptcy counseling, separate and apart from any IRS determination.

That the criteria for EOUST approval and tax-exempt status are separate and distinct has been made even clearer by IRS and Congressional actions this past year. In May, the IRS provided new guidance regarding the "methodology" analysis it would employ in its audits of credit counseling agencies. That guidance, while welcome, still leaves a great deal of subjective discretion to each IRS auditor. The credit counseling industry has noted that the actual exercise of that discretion has resulted so far in final and proposed revocations or terminations for one hundred percent of the CCAs where an audit has been concluded, and that the IRS has only approved 3 of 110 applications for tax-exempt status received from new CCAs as of May. If the EOUST tightly ties approved agency eligibility to tax-exempt status it may find that it has further diminished its ability to assure adequate long-term counseling resources.

We would also note that Congress recently enacted new statutory requirements for the achievement of tax-exempt status by CCAs as part of H.R. 4, the Pension Protection Act. Those statutory provisions provide welcome clarification of the structural and operational requirements for such status, and also make clear that the provision of DMPs is consistent with tax-exempt status so long as properly integrated with counseling and educational services, and so long as associated "fair share" income from creditors constitutes no more than fifty percent of an agency's revenues. We appreciate the efforts of Chairman Sessions, Finance Committee Chairman Grassley, and Senator Coleman to provide helpful clarification of Congressional intent regarding the impact of H.R. 4 on the credit counseling industry when that bill was debated on the Senate floor. Unfortunately, we are receiving reports that IRS field personnel are misinterpreting the effect of H.R. 4 and are taking negative actions based upon that misinformation. For example, an AICCCA member agency in the Midwest has been told by an IRS field agent that H.R. 4 prohibits any agency that offers a DMP from receiving or retaining Section 501c3 tax-exempt status. We are assisting that agency in attempting to correct this situation, and they are also working with the local office of their U.S. Senator. However, it remains unresolved, and we can only wonder how many other qualified CCAs are receiving adverse IRS treatment despite the Congressional intent evidenced in H.R. 4. We therefore urge the Subcommittee to communicate with IRS Commissioner Everson and to urge him to take immediate steps to assure that IRS staff both understand and impart the correct interpretation of H.R. 4.

While the counseling industry hopes that the recent Congressional clarification contained in H.R. 4 will reduce future IRS revocations, we continue to face the possibility that many agencies will be operating as non-profit entities lacking Section 501c3 tax-exempt status. The EOUST should not foreclose the availability of their resources to serve consumers in this event when they have met all the statutory requirements of BAPCPA and its implementing regulations.

5. Debt Settlement Plans

Bankruptcy Code Section 502(k) allows the court, on a debtor's motion and after a hearing, to reduce a claim based wholly on unsecured and non-dischargeable consumer debt by up to twenty percent, if the creditor unreasonably refused to negotiate a reasonable alternative repayment schedule proposed in a timely manner by an EOUST-approved CCA that would have provided for repayment of at least 60 percent of the debt during the loan's repayment period or a reasonable extension thereof.

This new provision potentially provides approved CCAs with some ability to negotiate a debt settlement plan on behalf of a debtor who lacks the financial resources to complete a one hundred percent repayment Debt Management Plan. That option would provide a whole new class of debtors with a non-bankruptcy repayment option similar to a Chapter 13 filing. However, it also makes a future legal right of the debtor contingent upon the present action of the approved CCA, and thereby it creates some potential legal liability for CCAs as well as some ethical questions. For example, is an approved CCA compelled to attempt to negotiate a sixty percent repayment plan on behalf of a debtor who has the financial capacity to make full repayment or can the CCA exercise some discretion when a debtor requests such action?

Given the potential of new forms of Debt Settlement Plans to provide benefits to both debtors and creditors, as well as the new responsibility thrust upon CCAs by Section 502(k), AICCCA believes that the EOUST should address this topic when it publishes more comprehensive proposed regulations later this year.

Conclusion

Overall, AICCCA believes that BAPCPA-mandated credit counseling has been successful and has had a beneficial affect on bankruptcy petitioners by providing them with possible alternatives and improving their understanding of specific personal financial issues. Mandated pre-discharge education will further serve to extend this consumer benefit and end the tragic circumstance of debtors emerging from bankruptcy without the requisite budgeting tools to avoid it in the future.

AICCCA appreciates this opportunity to provide input to the Subcommittee on these matters. We also appreciate the continuing dedication of the EOUST to the proper implementation of the required credit counseling provisions of BAPCPA, as well as the efforts of the IRS to ensure that consumers are protected from the small minority of credit counseling agencies who seek to take undue advantage of tax-exempt status.

Thank you for letting us share AICCCA's views with you. I would be happy to answer any questions.

JUDICIAL CONFERENCE OF THE UNITED STATES

STATEMENT OF
THE HONORABLE THOMAS S. ZILLY

SENIOR JUDGE, UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON

FOR THE
SUBCOMMITTEE ON ADMINISTRATIVE
OVERSIGHT AND THE COURTS
OF THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

HEARING ON
OVERSIGHT OF THE IMPLEMENTATION OF THE BANKRUPTCY
ABUSE PREVENTION AND CONSUMER PROTECTION ACT

December 6, 2006

Administrative Office of the U.S. Courts, Office of Legislative Affairs
Thurgood Marshall Federal Judiciary Building, Washington, DC 20544, 202-502-1700

**STATEMENT OF SENIOR JUDGE THOMAS S. ZILLY
ON BEHALF OF
THE JUDICIAL CONFERENCE OF THE UNITED STATES**

Mr. Chairman and members of the subcommittee, I am Senior Judge Thomas S. Zilly of the United States District Court for the Western District of Washington and chair of the Judicial Conference's Advisory Committee on Bankruptcy Rules. I am submitting this statement on behalf of the Judicial Conference of the United States, the policy-making arm of the federal courts, to report on the actions taken by the federal judiciary to implement the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act").

I welcome this opportunity to share with you some of the highlights of the hard work that the federal judiciary has done in implementing this comprehensive legislation within a relatively brief period of time. The provisions of the Act generally took effect on October 17, 2005, only six months after its enactment. The Act exceeds 500 pages in length and affects virtually every aspect of bankruptcy cases. Among other things, the law:

- Requires that debtors complete and pass a "means test" to be eligible to file for relief under Chapter 7;
- Specifies that individual debtors may not file a bankruptcy case unless they have received a credit counseling briefing by a nonprofit agency approved by the bankruptcy administrator or U.S. trustee for the district;
- Specifies that Chapter 7 and Chapter 13 debtors may not receive a discharge of their debts unless they have completed a financial management course approved by the bankruptcy administrator or U.S. trustee for the district;
- Makes extensive changes in Chapter 13 that affect the content of repayment plans, timing of confirmation, exceptions from discharge, length of time that the debtor must pay under a plan, and a number of other areas of Chapter 13 practice;
- Places additional duties on debtors-in-possession and trustees in Chapter 11 cases, alters the requirements for individual debtor Chapter 11 cases, and expedites the handling of small business Chapter 11 cases;

- Makes Chapter 12 reorganization for family farmers a permanent feature of the Code and adds family fishermen as a new group entitled to use Chapter 12;

- Includes new provisions governing health-care businesses;

- Adds a new Chapter 15 to the Code governing cross-border insolvencies that incorporates the Model Law on Cross-Border Insolvency drafted by the U.N. Commission on International Trade Law;

- Amends the appellate structure to allow certain appeals from decisions of bankruptcy judges to be taken directly to the courts of appeal;

- Requires significant changes in the form for reaffirmation agreements;

- Increases bankruptcy filing fees and reapportions them among the Treasury, the Department of Justice, and the Judiciary;

- Authorizes bankruptcy courts to waive filing fees for certain low-income debtors;

- Requires a significant increase in case management by bankruptcy judges;

- Substantially expands the statutory duties and the responsibilities of bankruptcy administrators and U.S. trustees;

- Requires bankruptcy administrators and U.S. trustees to conduct random audits of Chapter 7 and Chapter 13 cases to determine the accuracy, veracity, and completeness of the financial schedules and statements filed by debtors;

- Places additional responsibilities and liabilities on the attorneys for debtors;

- Requires the judiciary to collect and report new statistical data; and

- Authorizes 28 new temporary bankruptcy judgeships, which represents about half the number of bankruptcy judgeships requested by the Judicial Conference.

Implementing these provisions within the six months provided under the Act presented the federal judiciary with an unprecedented challenge. The Act's wide-ranging demands raised significant coordination problems that required not only the attention of judicial officers throughout the federal judiciary but also of officials within the Executive Office for United States

Trustees and other agencies, including the Internal Revenue Service, the Department of Health and Human Services, and the Census Bureau. A major segment of the federal judiciary, consisting of countless numbers of district court judges, bankruptcy court judges, bankruptcy court staff, Administrative Office staff, and Federal Judicial Center staff, was required on a short timetable to modify or develop new rules, forms, court procedures, computer software programs, statistical reports, manuals, and training programs, and to address a host of other tasks.

The added demands of the Act have increased the already enormous pressures to cope with the day-to-day responsibilities in the administration of justice, straining the federal judiciary's personnel and resources. Though the challenges were many and daunting, I am pleased to report that the judiciary has faithfully fulfilled its responsibilities and met the statutory deadlines.

I have attached a report on the impact of the Act, which was prepared by the Administrative Office for the United States House and Senate Committees on Appropriations, dated August 2006. The report summarizes many of the tasks that the judiciary accomplished in implementing the Act. I have also attached an internal Administrative Office document, which contains a detailed record of the major actions taken as of July 10, 2006, to fulfill the Act's requirements. The document was intended to be used solely as an internal management tool. But it also serves as a record that accurately captures the immense scope and magnitude of the federal judiciary's undertakings in executing the Act's provisions. A brief perusal of the 92-page report substantiates the extent of the federal judiciary's labors. I would like to highlight several of them.

Changes in Operating Procedures

Following a careful review of the Act, the judiciary developed guidelines and procedures addressing various new provisions added by the Act, such as those authorizing waiver of Chapter 7 filing fees, handling copies of debtor-tax returns filed with the court, nationwide noticing of creditors, and routing fraudulent statements to the Department of Justice. Significant changes were also initiated to reprogram the judiciary's Case Management/Electronic Case Files system (CM/ECF), which is now operational in virtually all bankruptcy courts. This system serves as the judiciary's docket, recording every action taken in cases filed in the federal courts.

Training

The Federal Judicial Center and the Administrative Office have instituted training programs for bankruptcy judges, bankruptcy clerks and bankruptcy administrators, and court staff, including case administrators in the clerks' offices, who will use the revised CM/ECF system. Court personnel have been trained at specifically-designated seminars, at conferences, and via the "FJTN," the Federal Judicial Center's closed-circuit television broadcast channel.

Bankruptcy Administrator Program

The Administrative Office has worked directly with the six bankruptcy administrator offices in the states of Alabama and North Carolina to prepare them to handle all the new duties and responsibilities required of them under the Act. These courts do not participate in the United States Trustee Program and are responsible for handling the trustees' duties themselves. First, the Act was analyzed to identify all the new duties, whether they are explicitly imposed on bankruptcy administrators by the Act or are needed to maintain parallel treatment with new duties imposed on United States trustees. The bankruptcy administrator offices were then notified of the changes in the law, changes in the courts' operating procedures, and changes to the bankruptcy administrators' own duties and responsibilities, such as overseeing means testing and small business Chapter 11 cases, certifying consumer credit counseling and financial management courses, and taking on new audit and reporting responsibilities. The Administrative Office has maintained regular contact with each bankruptcy administrator office. In addition, current bankruptcy administrator procedures and manuals have been revised substantially, and changes have been made to their automated case management systems.

Statistics

The judiciary's statistical systems have been substantially modified, both to adjust to the many changes in the bankruptcy system required by the Act generally and to comply with § 601 of the Act, which requires the Administrative Office to collect information and produce a new set of reports on consumer debtor cases. After the Judicial Conference approved amended and new bankruptcy forms, the Administrative Office worked closely with bankruptcy clerks to reprogram the case management system, design extraction programs, and build an entirely new enterprise data system capable of receiving and processing the data. The judiciary has recently begun collecting all the new required data and expects to produce the reports mandated under the Act within the specified deadlines.

Federal Rules of Bankruptcy Procedure

I would like to briefly report on the actions taken by the Advisory Committee on Bankruptcy Rules (the "Advisory Committee" or "Committee") to develop rules and Official Forms implementing the Act.

The Rules Enabling Act rulemaking process is set out in 28 U.S.C. §§ 2071-2077. It is a painstaking and time-consuming process that ensures that the best possible rules are promulgated. Soon after the Bankruptcy Act's enactment, the Advisory Committee decided that a two-track process was necessary to promulgate rules implementing the Act because its impending effective date of six months did not provide sufficient time to proceed under the regular rulemaking process, which ordinarily takes three years. Similar actions have been taken in the past to implement changes in or additions to the rules necessitated by amendments to the Bankruptcy Code. Under the first track, temporary interim rules were issued that apply to bankruptcy cases during a transitional period until the promulgation of national permanent rules. The Committee addressed two tasks: (a) identify which rules-related provisions in the Act required an immediate response; and (b) develop interim rules and forms addressing these time-sensitive provisions well before the October 17, 2005, deadline so that the courts would have adequate time to implement them. Under the second track, permanent national rules implementing the Act would be promulgated based on the interim rules. The Committee would monitor the courts' experiences with the interim rules and forms, simultaneously proceeding with the regular rulemaking process and inviting public comment beginning in August 2006 on converting the interim rules to permanent federal rules.

Under the first track, interim rules were circulated in August 2005 to the courts with a recommendation that they be adopted without change as part of a standing or general order. Recommending interim rules and authorizing Official Forms without going through the regular Rules Enabling Act rulemaking process was an unavoidable expedient compelled by the Act's effective date. To meet the Act's deadline, the Advisory Committee devoted substantial time and effort in developing interim rules and forms that faithfully implemented the Act. It worked closely with the Executive Office for United States Trustees. It consulted with experts who participated in the legislation, who at times disagreed among themselves over the meaning of particular provisions in the Act, making the Committee's job all the more difficult. It reached out to many corners of the bar for assistance. It relied on its members' varied experiences, including members who represent creditors and others who represent debtors in their private practice. All these efforts were undertaken in an open fashion to ensure that the process remained transparent, a hallmark of the rulemaking process. The bankruptcy courts incorporated virtually all the interim rules into their local rules. The interim rules were well received by the bench and bar.

The Advisory Committee has initiated the second track, publishing proposed amendments to the Federal Rules of Bankruptcy Procedure based on the interim rules for public comment in August 2006 for a six-month period ending February 15, 2007. The Committee also published for comment additional proposed rule amendments not included as part of the time-sensitive interim rules package.

In accordance with the regular rulemaking process, the Advisory Committee will review public comments and any statements submitted on proposed amendments to 32 existing rules, 8 new rules, 20 existing Official Forms, and 5 new Official Forms implementing the Act at its March 2007 meeting. If approved, the Committee will transmit the proposed rules and forms to the Committee on Rules of Practice and Procedure (Standing Committee) in June 2007 with a recommendation that they be approved and submitted to the Judicial Conference at its September 2007 session. If approved by the Standing Committee and the Conference, the proposed rules will then be submitted to the Supreme Court for its consideration. (Changes to the Official Forms, however, do not have to be approved by the Court and most of them took effect in late

2005. Additional changes may be made to the forms in light of public comment.) The Court has until May 1, 2008, to prescribe the rules and transmit them to Congress. The rules then will take effect on December 1, 2008, unless Congress acts otherwise.

At each stage of the rulemaking process, the proposed rule amendments and forms have been subjected to exacting scrutiny. Participation of the bench, bar, and public in the rules process ensures that the procedural rules implementing the Act, which were initially adopted as interim rules, will be the best that we can conceive.

As part of its review of the proposed rules amendments, the Advisory Committee has under study the concerns raised by Senator Charles E. Grassley and Senator Jeff Sessions in their March 13, 2006, letter to the late Chief Justice William Rehnquist about pleading requirements involving a motion to dismiss, the effect of an attorney's signature on a pleading, and the means-testing forms. (A copy of the letter and the Committee's response are attached.) In addition, the Committee has reviewed § 319 of the Act as it relates to the sense of Congress that Rule 9011 be modified.

At its September 2006 meeting, the Advisory Committee considered the Senators' concerns and specifically addressed the concern about the attorney's responsibility to investigate the accuracy of underlying facts contained in the petition, pleadings, or written motions. The Committee agreed, subject to reconsideration in light of forthcoming public comment, to revise the "Voluntary Petition" consistent with the Act in cases involving an individual debtor whose debts are primarily consumer debts to include a warning under the attorney's signature that the signature constitutes a certification that the attorney has no knowledge, after an inquiry, that the information in the schedules filed with the debtor's petition is incorrect. The Committee is studying whether Rule 9011 itself should also be amended to address these concerns, and if so, whether the amendment should be limited to Chapter 7 cases only, or whether it should be extended to all Chapters for cases filed by individuals whose debts are primarily consumer debts. The Committee has also implemented changes to the means test form, which became effective as Official Forms on October 1, 2006.

The amount of work required of the judiciary as a whole to implement the Act has been immense and costly, especially considering the short timeframe available to accomplish the extensive revisions required of the existing systems. The judiciary has responded admirably to the demands placed on it by the new legislation. I believe that the steps taken and those that are under further review will ensure that the Act will be fully implemented according to the intent of Congress.

Thank you.

COMMITTEE ON RULES OF PRACTICE AND PROCEDURE
OF THE
JUDICIAL CONFERENCE OF THE UNITED STATES
WASHINGTON, D.C. 20544

DAVID F. LEVI
CHAIR

PETER G. McCABE
SECRETARY

CHAIRS OF ADVISORY COMMITTEES

CARL E. STEWART
APPELLATE RULES

THOMAS S. ZILLY
BANKRUPTCY RULES

LEE H. ROSENTHAL
CIVIL RULES

SUSAN C. BUCKLEW
CRIMINAL RULES

JERRY E. SMITH
EVIDENCE RULES

December 20, 2006

Honorable Charles E. Grassley
United States Senate
135 Hart Senate Office Building
Washington, DC 20510-6276

Dear Senator Grassley:

I regret that I was unable to appear at the oversight hearing held on December 6, 2006, on the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (the "Act") before the Senate Committee on the Judiciary Subcommittee on Administrative Oversight and the Courts. I was in the middle of a criminal trial and could not attend. I submitted a statement on behalf of the Judicial Conference of the United States, which included extensive attachments documenting the enormous efforts undertaken by the federal judiciary in implementing the Act. I respectfully request that this letter be made part of the record of the oversight hearing.

I would like to take this opportunity to address an issue that you raised in your written statement prepared for the hearing. You noted that: "[i]t's my understanding that this form actually directs consumers to claim deductions for expenses a debtor may not even have. That certainly wasn't the intent of the law." The reference is to entry line 22 of Official Form 22A (means test form), which deals with a debtor's transportation expenses in a Chapter 7 consumer bankruptcy case. The form was developed by the Advisory Committee on Bankruptcy Rules and, with the Judicial Conference's approval, took effect on October 17, 2005. Entry line 22 notifies the debtor that: "[y]ou are entitled to an expense allowance in this category regardless of whether you pay the expenses of operating a vehicle and regardless of whether you use public transportation." The Advisory Committee concluded that the plain language of the Act required this result.

The Act establishes a means test designed to identify abusive petitions filed by debtors. The first step of the test is to calculate the debtor's current monthly income as defined under the Act. Specified deductions are then allowed from the current monthly income. If the net result is more than a certain amount, the filing is presumed abusive. One of the deductions allowed under § 707 of the Bankruptcy Code (as amended by § 102 of the Act) pertains to transportation expenses, the subject of entry line 22.

Honorable Charles Grassley
Page 2

Section 707(b)(2)(A)(ii) of the Code is clear and leaves no room for interpretation. It delineates calculation methods for two categories of a debtor's expenses. The two categories of deductions are those set out in the National Standards and Local Standards as issued by the Internal Revenue Service. A copy of the relevant sections is attached for your convenience. Under the first category of deductions, which applies, among other things, to transportation expenses, the "debtor's monthly expenses *shall be* the debtor's applicable expense amounts specified under the Internal Revenue Service National Standards and Local Standards..." (emphasis added). The IRS National Standards provide a specific allowance for food, clothing, household supplies, and personal care, depending on income and household size. The IRS Local Standards specify an amount for housing and utilities expenses and a separate amount for transportation expenses, depending on location. Though the amount of transportation expenses permitted under the IRS Local Standards sets a cap on actual expenses in the context of tax laws, the Act's plain language entitles a debtor to an allowance for this amount for purposes of calculating the means test in the same way that the Act provides an allowance for food and clothing expenses. This meaning is underscored by the provision immediately following, which applies to other expenses.

Under the same subparagraph of § 707(b)(2)(A)(ii), the "debtor's *actual monthly expenses* for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides ..." (emphasis added) are authorized as allowable deductions. The language of this provision is equally unequivocal and, unlike food and transportation expenses, requires itemization of "other necessary" expenses actually incurred by the debtor. The juxtaposition of the two provisions in the same sentence makes clear that Congress deliberately adopted different methods of calculating these two types of expense deductions. In the first category a debtor may include an allowance for food, clothing, transportation, household supplies, and personal care specified in the IRS standards; in the second category a debtor may include other necessary expenses <u>only</u> to the extent actually incurred by the debtor.[1]

The Advisory Committee's overarching obligation in developing the Official Forms was to faithfully execute the Act's language. The Act's language governing the calculation of deductions for transportation expenses in entry line 22 is clear and compelling.

Official Form 22A was not originally published for public comment in accordance with the regular rulemaking process, because the Act provided short time deadlines and the form was needed well before the Act's effective date. In order to obtain the public's input, all forms

---

[1]The House Judiciary Committee Report on S. 256, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, explains the operation of this provision and says: "[T]he debtor's monthly expenses ... must be the applicable monthly amounts set forth in the Internal Revenue Service Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories and the debtor's actual monthly expenditures for items categorized as Other Necessary Expenses." H.R. Rept. No. 109-31 (Part 1) (2005).

implementing the Act have now been published for public comment in August 2006 for a six-month period, expiring February 15, 2007. I will advise the Advisory Committee of your concerns with Form 22A at its March 29-30, 2007, meeting, when it will consider all comments submitted on the forms.

Thank you.

Sincerely,

Thomas S. Zilly

Thomas S. Zilly
Chair, Advisory Committee
on Bankruptcy Rules

Enclosures

cc: Honorable David F. Levi
Honorable Jeff Sessions
Honorable Arlen Specter
Honorable Patrick J. Leahy
Honorable Orrin Hatch

STATEMENT OF

SUSAN C. KEATING

PRESIDENT AND CEO

NATIONAL FOUNDATION FOR CREDIT COUNSELING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT
AND THE COURTS

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

December 6, 2006

Mr. Chairman, Members of the Subcommittee, I am Susan Keating, President and CEO of the National Foundation for Credit Counseling ("NFCC"). The NFCC was founded in 1951 and is the nation's largest and longest serving nonprofit financial counseling and education organization. The NFCC's mission is to create a national culture of financial responsibility. Through its 115 member agencies, the NFCC sets the national standard for the highest quality financial education, credit counseling, debt reduction and related consumer services. All NFCC-member agencies are nonprofit 501(c)(3) entities under the Internal Revenue Code. With offices in nearly 1,000 communities throughout the United States and Puerto Rico, NFCC members help two million consumers annually.

In 2005, Congress embarked on a new course to develop a bankruptcy system that appropriately balances the interests of debtors and creditors. Congress passed, and President Bush signed, the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA").

Through BAPCPA, for the first time, Congress acted to aggressively promote financial education and training by requiring debtors to participate in financial counseling sessions prior to filing for bankruptcy and to take a course on personal financial management before their debts could be discharged. Although the NFCC did not take a position on the overall legislation, the NFCC strongly supports the counseling and financial education requirements of BAPCPA. Those requirements represent a landmark public policy decision that could help provide millions of at-risk Americans with the skills and the tools to better manage and to take charge of their financial lives.

The approach of BAPCPA's October 17, 2005 effective date brought with it many uncertainties. Some believed the pre-filing counseling requirement would reduce the overall number of filings. Others believed that bankruptcy was typically a last resort for individuals who were truly financially overwhelmed and they predicted the new law would have little impact on filings. The NFCC believed that regardless of the impact on the number of filings, pre-filing counseling would help consumers to better understand their financial situation, bankruptcy and the alternatives to bankruptcy, and empower them to make an informed decision about their financial future. As I will outline, while it is difficult to measure, we believe that to be a significant consumer benefit.

There was substantial anxiety about whether the credit counseling sector would be able to meet the new demand for counseling services. Some projected the workload would double and feared that agencies lacked the resources to sufficiently expand capacity to meet the new counseling mandate.

It is clear a year later that, led by NFCC-member agencies, the credit counseling sector has met the demand for services. However, it is also clear that as a result of – or in spite of – BAPCPA, the number of bankruptcy filings fell to historic lows. I will leave it to others to debate causation, but one thing that is clear is that consumers who sought pre-filing counseling were able to obtain it, and they obtained it mostly from NFCC-member agencies.

A word of caution is in order. Should bankruptcy rates return to the norms of recent years, it is not clear whether the credit counseling sector can continue to meet the BAPCPA mandate. Likewise, it is too soon to state conclusively whether the new law has provided consumers with the intended immediate and long-term benefits.

The passage of BAPCPA triggered a tidal wave of bankruptcy filings as financially troubled consumers were seemingly frantic to obtain bankruptcy relief before the new law took effect. Nearly 620,000 Americans filed bankruptcy petitions in October 2005 alone, compared with 237,000 filings in September and average monthly filings in the range of 130,000 -150,000 prior to passage of BAPCPA.

In the debate over the effectiveness of BAPCPA, it should be noted that in the total filings, the overall percentage of Chapter 13 filings (which require repayment plans) rose from about 29 percent of the total in 2000-2004 to more than 41 percent in the first half of 2006. Chapter 13 filings accounted for just 20 percent of the 2005 filings, but that figure was likely skewed by the pre-emptive October surge. In the first two months after October 17, Chapter 13 filings actually accounted for almost 60 percent of all filings – which suggests that those who expected to participate in repayment plans were less concerned about the provisions of BAPCPA than those seeking a discharge under Chapter 7.

Annual Personal Bankruptcies

Year	Chapter 7	Chapter 13	Total
2002	1,109,923 (70.9%)	455,877 (29.1%)	1,565,800
2003	1,176,905 (71.3%)	473,137 (28.7%)	1,650,042
2004	1,137,958 (71.7%)	449,129 (28.3%)	1,587,087
2005	1,659,017 (80.1%)	412,130 (19.9%)	2,071,147
2006 (Jan-June)	155,523 (58.8%)	109,173 (41.2%)	264,696
Source – Administrative Office of the U.S. Courts			

After October 17, 2005, the number of bankruptcy filings fell dramatically. In the final two months of 2005 combined, new filings totaled just 35,000. In the first 11 months of this year, nearly 500,000 new bankruptcy filings were recorded. For all of 2006, Visa projects filings to fall below 600,000 – the lowest level in almost 20 years.

The dramatic decline in bankruptcy filings after October 17, 2005 eased the pressure on credit counseling agencies, especially during the early months of the transition. Though the demand for counseling services rose substantially compared to the year before, agencies were able to accommodate all who sought services during the first year of BAPCPA. Still, as I will detail in a moment, the influx of bankruptcy-related clients created new financial pressures on agencies which drove some adjustments in the way counseling services are provided.

NFCC Agencies Embraced the BAPCPA Mandate

Nearly all NFCC-member agencies applied for and received approval from the U.S. Department of Justice Executive Office for United States Trustees (EOUST)[1] to provide either pre-filing counseling or pre-discharge education during BAPCPA's first year. The vast majority of NFCC-member agencies were approved to provide both services. As of October 6, 2006, 108 NFCC-member agencies had received EOUST approval to provide pre-filing counseling and 98 NFCC-member agencies had been approved to offer pre-discharge education. **NFCC agencies represent nearly two-thirds of all agencies approved to provide pre-filing counseling** and 35 percent of those institutions approved to deliver pre-discharge education sessions.

During the law's first 11 months, NFCC agencies completed 436,937 pre-filing sessions and 126,557 pre-discharge sessions. The agencies issued pre-filing certificates for course completion to 485,963 individuals for pre-filing sessions and 144,459 pre-discharge certificates. The number of certificates exceeded the number of counseling sessions because spouses often attend sessions jointly, but are entitled to individual certificates. In addition, debtors may attend group sessions, but those completing the counseling and/or education course receive individual certificates.

---

[1] The EOUST is responsible for the administrative regulation and oversight of the bankruptcy-related counseling and education programs in all states except North Carolina and Alabama. In those two states, that function is performed by the district Bankruptcy Administrators under the auspices of the Administrative Office of the United States Courts (AOUSC). For the most part, the programs under the AOUSC parallel those under the EOUST. Unless otherwise noted, for purposes of this testimony, references to the EOUST should be interpreted to also incorporate the appropriate data or operations in North Carolina and Alabama under the AOUSC.

NFCC Member Bankruptcy-Related Service Delivery
October 17, 2005 through August 31, 2006

	Total Sessions Conducted	Total Certificates Issued
Pre-filing Counseling	436,937	485,963
Pre-discharge Education	126,557	144,459
Totals	**563,494**	**630,422**

The agencies also continued to provide counseling sessions to individuals who sought financial assistance but were not considering bankruptcy. Non-bankruptcy related sessions totaled more than 600,000 during this same period.

Bankruptcy Filers Are Overwhelmed by Debt

Although the number of bankruptcy filings has dramatically decreased, the overwhelming majority of those consumers who sought pre-filing counseling in contemplation of bankruptcy appeared to be in dire financial condition. Here again, I will defer to others to draw their own conclusion from those data points; however, by the time most consumers walked into a credit counseling agency for their pre-filing counseling, their financial circumstances were so desperate that bankruptcy was often their only reasonable option.

NFCC surveys showed that consumers who signed up for pre-filing counseling carried debt loads that substantially exceeded their income. This experience differs from NFCC-member agency non-bankruptcy counseling where average annual income exceeds average unsecured debt.

Comparative Financial Data for Consumers Who Receive
Pre-filing Credit Counseling

	Average Unsecured Debt	Average Annual Income	Unsecured Debt to Income Ratio
Six Month Survey	$40,673	$31,255	1.3
One Year Survey	$38,472	$26,873	1.43

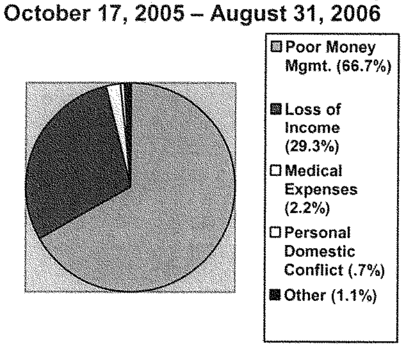
Comparative Financial Data for Consumers Who Receive Non-bankruptcy Credit Counseling

	Average Unsecured Debt	Average Annual Income	Unsecured Debt to Income Ratio
Six Month Survey	$20,997	$36,601	.57
One Year Survey	$22,597	$31,143	.73

In addition, mortgage delinquency data provided another indication of the two groups' relative degree of financial stress. Among those agencies reporting, 42 percent indicated that between 26 and 100 percent of their pre-filing clients were delinquent with their mortgage which is significantly higher than reported for their non-bankruptcy counseling clients during the same period.

Agencies reported that the number one reason consumers intended to file for bankruptcy was "poor money management/excessive spending." Looking at the top three reasons combined, "reduced income/unemployment" was cited nearly as frequently as "poor money management" as the main cause of financial distress for individuals on the edge of bankruptcy. Both were listed by approximately one-third of those who received pre-filing counseling. By comparison, medical expenses/accident/disability was cited by about 29 percent as a top reason.

Primary Reason Individuals Require Bankruptcy Counseling
October 17, 2005 – August 31, 2006



Note: Agencies noted that 43 percent of the time clients identify the reason that caused them to seek bankruptcy protection versus 48 percent of the time where the client and/or a counselor determine the reason. However, additional study should be conducted to better define the category of "poor money management."

Of the total consumers seeking pre-filing counseling, only a relatively small percentage, 3.4 percent, elected to enter into a voluntary repayment program outside of bankruptcy, known as a debt management plan ("DMP"). That may reflect the consumers' dire financial condition, the lack of enhanced creditor concessions to potential bankruptcy debtors, or a number of other factors. It is a point which certainly deserves further scrutiny, but at this time, there is not sufficient data surrounding it from which broader conclusions – pro or con – may be drawn.

I offer two comments from NFCC-member agencies about the implementation of BAPCPA for the Subcommittee's consideration:

"I think the law was intended to give clients options but the people who come to our agency for pre-filing counseling sessions really have no other options by the time they get to the point of seeking bankruptcy," said one counselor. "We still educate them on options and alternatives in general, but it doesn't seem to help their current situation."

Counselors noted that many consumers have paid legal fees before meeting with a credit counselor and may believe that deciding not to file means the legal fees would be wasted. "It seems that all of the clients have already seen an attorney and made a decision prior to meeting with our counselors," said another counselor. The issue of "attorney-steering" or its impact on the consumer's decision prior to obtaining the pre-filing counseling may be an issue that the Subcommittee may wish to explore in detail.

Also, as an example of potential enhanced creditor concessions, provisions of BAPCPA are intended to encourage unsecured creditors – primarily credit card issuers – to accept an offer from a potential bankruptcy debtor to repay 60 percent of the outstanding debt over a five-year term as an alternative to filing for bankruptcy. To date, this alternative is still in the formulative stage as there is a lack of consensus among both the creditor community and regulators about how it would operate in practice and its impact on the "safety and soundness" of a creditor's loan portfolio. The NFCC is working with a number of stakeholders to determine how best to gain traction around this product alternative.

"Distance Counseling" Predominates

The credit counseling sector is seeing a growing trend toward distance learning channels in the delivery of counseling and education sessions to consumers, including the bankruptcy counseling and education area. Counseling and educational services delivered by phone and online is gaining currency.

Over the first year of BAPCPA, the vast majority of bankruptcy-related counseling took place either by phone or over the Internet, with telephone counseling the preferred option. Face-to-face counseling, the costliest form of service for agencies to provide, accounted for only about 15 percent of pre-filing counseling and slightly more than 38 percent of pre-discharge education. Phone counseling accounted for 61 percent of pre-filing sessions and for 38 percent of pre-discharge education. Internet services accounted for 24 percent of both pre-filing counseling and pre-discharge education.

Delivery of Service Channel Mix
October 17, 2005 – August 31, 2006

	Face-to-face	**Phone**	**Internet**
Pre-filing Counseling	15%	61%	24%
Pre-Discharge Education	38%	38%	24%
Non-bankruptcy Counseling	36%	45%	19%

The choice of distance counseling reflects the preference of many bankruptcy counseling clients. However, the NFCC believes that some external groups are advocating for faster and cheaper counseling and education services. Cost may also play a role in agency decisions about delivery architecture.

The NFCC believes effective counseling is possible through all three delivery channels and testing by member agencies shows that consumers gain knowledge through all three modes. For consumers in remote locations, distance counseling may be the only feasible option.

And, I would like to stress this point: I don't think we can say that one delivery method is preferable in every circumstance. The best option likely varies from consumer to consumer and his or her particular circumstance. **But as a matter of policy, consumers must retain the ability to choose the counseling method that best suits their needs.** Congress and the EOUST must be vigilant against developments that would limit consumer choice or which would dilute effective counseling and education in favor of "faster and cheaper" or "drive-by" service models.

Funding

No matter the delivery mode, fees charged to consumers for pre-filing bankruptcy counseling typically fail to cover the agency's cost of providing the services. Not surprisingly, the gap is largest for in-person counseling.

Costs to Deliver Pre-filing Counseling
October 17, 2005 – August 31, 2006

	Average Cost to Agency to Provide Service	Average Fee Received from Consumer	Net
Face-to-Face	$54.92	$37.41	($17.51)
Phone	$52.47	$38.11	($14.36)
Internet	$44.91	$40.04	($4.87)
Across all Channels	**$50.96**	**$38.47**	**($12.49)**

Based on current estimates from Visa of approximately 600,000 bankruptcy filings for 2006 and assuming the same delivery mix, an annual funding shortfall of $7.52 million appears likely for NFCC-member agencies for pre-filing counseling this year. To cover that shortfall, agencies have been forced to shift funds from other programs, and in many cases, invade financial reserves.

It is too soon to determine the funding shortfall associated with pre-discharge education sessions as agencies are utilizing a greater mix of group and individual sessions and self-study with instructor/counselor to apply existing cost assumptions.

"Our one concern is whether we will be able to continue to provide the level and quality of pre-filing service to these clients. Our fees do not cover our expenses, and other funding sources are reluctant to assist with providing these services," one agency said in response to an NFCC survey.

Because bankruptcy filings in 2006 will be lower than previously projected, the funding gap between the cost of providing bankruptcy-related counseling and the fees collected during BAPCPA's first year will be somewhat less than we estimated at BAPCPA's six-month anniversary. While this reprieve is welcome, it does not change the fundamental challenge of providing service that cannot be fully covered by customer fees.

The NFCC strongly supports the provision in BAPCPA that require EOUST-approved agencies to provide services without regard to the debtor's ability to pay for them. NFCC-member agencies have a long history of providing services to consumers without regard to their ability to pay any fee for them. However, the gap between cost of service and revenue was widened substantially by waivers for clients who could not afford to pay the fee. On average, NFCC agencies reported 16 percent of fees for pre-filing bankruptcy counseling and 13 percent of fees for pre-discharge education were waived during this period.

The NFCC does not favor raising fees charged to consumers to close the gap as many consumers contemplating bankruptcy lack the ability to pay higher fees. In addition, higher fees might actually exacerbate the funding gap by resulting in more waivers because of the financial condition of filers. BAPCPA limits fees to a "reasonable" amount. While "reasonable" is not defined by the law, the NFCC believes that it is intended to keep fees low. Other alternatives – such as funding from other stakeholders, such as creditors, and the government – must be considered.

Measures of Success

While the NFCC surveys have provided important information about BAPCPA's implementation, they do not yet enable us to pass judgment on the law's success as an instrument of public policy. Some have attempted to draw conclusions from such short-term developments as the decline in bankruptcy filings, the relative proportion of Chapter 7 and Chapter 13 filers in the past year, or the number of consumers who opt *not* to file for bankruptcy after receiving credit counseling. But the NFCC believes we do not yet have the evidence to draw any definitive conclusions.

For one thing, it is not at all clear that the bankruptcy trends of the past year represent a new norm. In fact, it is more likely that 2006 will turn out to be a unique year skewed by consumers' uncertainty about the new law and their rush to file before the October 17, 2005 effective date. In our view, we need several years of data before we can say with confidence that a new norm has been established.

Although still low by historic standards, monthly bankruptcy filings have climbed steadily this year and some estimate that they will likely again cross the one million level in 2007. An increase in 2007 could be led by external forces such as changing energy prices, weakness in the housing market, or the resetting of more than a trillion dollars in adjustable mortgages, any and all of which would negatively impact consumer cash flow and ability to manage their obligations.

New Measurements Needed to Assess Counseling's Impact

More fundamentally, we believe that data such as the number of bankruptcy filings or the nature of those filings will offer only a partial verdict on BAPCPA. From the perspective of the NFCC and its member agencies, the biggest hope for beneficial change lies with BAPCPA's credit counseling and financial education provisions and the possibility that it is a first step in improving Americans' financial literacy.

As NFCC surveys demonstrate, one of the principal reasons for bankruptcy is that large numbers of Americans are simply not very good at managing money. No doubt, some Americans lack income or are impacted by event-related problems; but, based on our experience, a larger number lack the financial skills and tools to adequately handle their finances and financial emergencies. We need to determine whether the required counseling and education enable more Americans to manage their finances successfully and avoid future financial difficulties once they emerge from bankruptcy.

Initial indications are positive. Many NFCC agencies tested clients' knowledge both before and after they completed bankruptcy-related counseling, and within pre-discharge education sessions. These agencies found that client test scores improved from 10-to-40 percent as a result of counseling, and that the improvements took place whether counseling was delivered in person, over the phone, or via the Internet.

Agencies also reported that their surveys of bankruptcy-related clients show satisfaction with the counseling sessions; that consumers regret that they did not participate in financial education sooner; and that consumers vow to apply their new knowledge to future money management. What is not known is whether the enhanced test performance by those who completed counseling programs represent permanent gains or merely short-term retention. Nor do we know if consumers will, in fact, change the way they approach managing their money.

Traditional outcome measurements, driven largely by the creditor community, include tracking improvement in FICO scores or percentage of debt repayments. While such measures have value, they do not tell us whether the lessons learned in financial counseling courses will stick, whether the literacy gains are genuine, or whether behavior will change for the long term. To gauge the impact of the law, and its consumer counseling requirements, we need to answer those questions. That will take time, and it also will require better measurements.

As part of its continuing commitment to financial literacy and to address this issue in the context of the new bankruptcy law, the NFCC has created an

"Outcomes and Impact Task Force." Through the work of this Task Force, the NFCC will create a set of solid performance metrics that will quantify substantive change among our clients who receive our services. These measures will be directed towards measuring 1) behavioral change; 2) increased knowledge; and 3) attitudinal changes.

Looking to the Future

In conclusion, we think it unlikely that the number of bankruptcy filings will continue at historic lows. We continue to believe that pre-filing counseling and pre-discharge education is a significant benefit to consumers by providing them with information, including alternatives to bankruptcy and the knowledge and skills to achieve financial independence. We believe that consumers should have the option of choosing the method of delivery of those sessions that best meet their individual needs. While NFCC agencies are well qualified and committed to providing those mandated services, we believe that additional funding sources are needed to assure that they remain available to consumers.

Each individual we counsel seeks financial independence and wellness. It is the NFCC's job and mission to put them on that path. We believe that is also the objective of the counseling and education provisions of BAPCPA. Although it is too early to ultimately assess the impact of the law, we are making progress and it is our intention to continue to address the issues I have raised today. Our success, as well as actions by Congress and other stakeholders in providing assistance in meeting those challenges, may very well determine whether BAPCPA earns a passing grade.

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to present this testimony. I would be pleased to respond to any questions that you may have.

WRITTEN TESTIMONY OF PROFESSOR ROBERT M. LAWLESS
University of Illinois College of Law
December 6, 2006

My name is Robert Lawless. Thank you for extending me the privilege of addressing you today. I teach and write about bankruptcy at the University of Illinois College of Law. As a legal scholar, my aim is to examine the empirical reality of how law affects the people it regulates. I have published numerous papers using publicly available government data as well as data collected from bankruptcy court files and from talking to people who file for bankruptcy. What my work teaches me is that the new bankruptcy law helps the credit industry, not consumers, and that the provisions of the law are leading to harsh results in the bankruptcy court.

Although the new law was called the Bankruptcy Abuse Prevention and Consumer Protection Act or BAPCPA, it addressed abuses that did not exist and protected the credit industry instead of consumers. Nevertheless, we were told the law was necessary because bankruptcy had lost its power to shame.[1] The decision to file bankruptcy was made to sound as if it were a lifestyle choice. Just before the bill passed, Professor Zywicki, one of today's witnesses, told the full Judiciary Committee that the bankruptcy system was a tax on our society. Changes in the bankruptcy law could lower interest rates and lower prices.[2]

In the new law, the consumer credit industry got just what it wanted. Industry lobbyists were able to fill BAPCPA with provisions to benefit banks, auto lenders, credit card companies, landlords, and nearly any other business that loaned money to

[1] Edith H. Jones & Todd Zywicki, *It's Time for Means-Testing*, 1999 B.Y.U. L. Rev. 177, 180.
[2] Testimony of Professor Todd J. Zywicki at the Hearing on Bankruptcy Reform of the Subcommittee on Administrative Oversight and the Courts of the Senate Judiciary Committee (Feb. 10, 2005) (available at http://judiciary.senate.gov/testimony.cfm?id=1381&wit_id=3997).

consumers. Congress passed the law, and the president signed it despite the warnings of bankruptcy academics, judges, and lawyers.

Have interest rates gone down? According to the Federal Reserve, interest rates on personal loans and credit cards are the same today as they were just before BAPCPA went into effect.[3] What about credit card fees? For the three months ended September 30 of this year, Citigroup reported it made $1.3 billion in fees on credit and bank cards, an 8% increase over the same time period one year previous.[4] In October, Wells Fargo increased late fees on its largest credit card accounts 11%, from $35 to $39 for each late payment.[5] What about the claim that the old bankruptcy law led to higher prices? The new bankruptcy law certainly has not stopped consumers from paying more for goods and services than they did one year ago.

Where are the benefits of the new law? They are in the pockets of the consumer credit industry. Read the quarterly financial reports of the publicly traded major consumer lenders. Almost every one reports larger revenues and profits in their credit card business since the new law was passed. American Express, for example, reported operating income of $956 million for the third quarter of 2006 alone, an increase of 10% from the previous year.[6] Also for the third quarter of 2006, Wells Fargo reported an 11% rise in total net income, $2.19 billion.[7]

On its one-year anniversary, supporters of the new bankruptcy law lauded the dramatic decline in bankruptcy filings as proof that the bill had worked. It is true that

---

[3] Federal Reserve Statistical Release [illegible].19, "Consumer Credit" (Nov. 7, 2006).
[4] Citigroup, Inc., Quarterly Report (Form 10-Q) (Nov. 3, 2006).
[5] David Lazarus, *Bank's Cloudy Wording*, S.F. Chron., Nov. 3, 2006, at D1.
[6] *Amex Reports Profit*, N.Y. Times, Oct. 24, 2006, at C5 ("American Express said yesterday that its third-quarter profit exceeded Wall Street projections, reflecting robust returns from its credit-card business.").
[7] *Wells Fargo Profit Up*, N.Y. Times, Oct. 18, 2006, at C3.

bankruptcy filings are currently about half the level they were before the new law took effect. Some critics of the new law predicted that the dip would be short-lived, and bankruptcy filings would soon return to their previous levels. There is some reason to believe that may occur. Bankruptcy filings are trending upward. Frankly, however, it is too soon to tell whether BAPCPA led to a permanent readjustment of the U.S. bankruptcy filing rate.

In any event, fixating on the number of people who file bankruptcy is a fool's errand. Blaming the bankruptcy system for bankruptcy filings is like blaming hospitals for serious illnesses. That conflates cause (financial distress) and treatment (bankruptcy court). In enacting BAPCPA, Congress did nothing but close the hospital for financial distress, doing nothing to help middle-class Americans struggling to make ends meet.

Of course, bankruptcy filing rates have gone down. The onerous new requirements on attorneys who represent consumers and the new law's complexity have caused attorneys' fees to rise 50-100%. In an ongoing research project of mine, a preliminary review of court files under the new law revealed routine requests for chapter 7 attorneys' fees of $1,000 to $1,500, and routine requests for chapter 13 fees from $2,000 to $3,000, precisely the amounts that attorney's fees were predicted to rise. BAPCPA also increased court filing fees, and imposed new credit counseling and paperwork requirements, each of which made bankruptcy a more time-consuming (and hence expensive) endeavor. Just as Americans drive less when the cost of gasoline rises, they will use bankruptcy less when its costs increase. And, just like increases in the cost of gasoline, a costlier bankruptcy system falls hardest on working, middle-class Americans.

There is reason to believe that consumer financial distress is on the rise. In the third quarter of 2006, credit card delinquency rates are 12% higher than they were just before the law went into effect.[8] Home mortgage debt is almost 75% higher today than it was five years ago,[9] and over 300,000 properties entered some stage of foreclosure in the third quarter of 2006, an increase of 43% compared to the same time one year ago.[10] The *Boston Globe* and *New York Times* have run multi-part stories about increasingly harsh tactics by consumer debt collectors.[11] With consumers owing more and with a less accessible bankruptcy system, it is not surprising that debt collectors have turned the screws.

From bankruptcy courts and practitioners, we are hearing stories about the law's harsh application. A disabled debtor who had not worked in years and not had enough income to file an income tax return since the early 1970s was faced with a trustee's demand he produce those thirty-year old tax returns because the new law requires the debtor to produce the most recently filed return. Two judges have interpreted the law to require dismissal of a bankruptcy case when the debtor receives credit counseling the same day as the bankruptcy filing.[12]

In contrast to the debtors who received credit counseling on the day of filing bankruptcy, a Texas bankruptcy judge had a case with married debtors who had received credit counseling within 190 days, rather than 180 days, of filing bankruptcy, as the new

---

[8] Federal Reserve, "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," available at http://www.federalreserve.gov/releases/chargeoff/delallsa.htm.
[9] Federal Reserve Statistical Release Z.1, "Flow of Fund Accounts of the United States," tbl. L.10 (Sept. 19, 2006).
[10] RealtyTrac, "National Foreclosures Increase 17 Percent in Third Quarter" (Nov. 1, 2006) (available at http://www.realtytrac.com/ContentManagement/PressRelease.aspx?ItemID=1362).
[11] Sewell Chan, *An Outcry Rises as Debt Collectors Play Rough*, N.Y. Times, July 5, 2006, at A1; Michael Rezendes, et al., *No Mercy for Consumers: Firms' Tactics Are One Mark of a System That Penalizes Those Who Owe*, Boston Globe, July 30, 2006, at A1.
[12] *In re* Cole, 347 B.R. 70 (Bankr. E.D. Tenn. 2006); *In re* Mills, 341 B.R. 106 (Bankr. D.D.C. 2006).

law requires. They had tried to use the time to negotiate with their creditor. As the judge wrote, "[T]he Court is obliged to dismiss regardless of the fact that Debtors 'almost' met the requirements of the statute, regardless of the fact that Debtors seem to have satisfied Congressional objectives that were enacted as part of the statute, regardless of the fact that no one contends that Debtors were not in good faith, regardless of the fact that no one contends that they did not make a zealous effort to accomplish the Congressional objective, and regardless of the fact that no useful purpose will apparently be served by dismissal."[13]

Another bankruptcy judge had a case with married debtors who were trying to work with a mortgage lender to repay a debt and avoid foreclosure. The lender would not confirm the precise amount of the debt and at the last minute refused to accept payment. When the creditor initiated foreclosure proceedings, the debtor made an emergency bankruptcy filing. The court had to dismiss the case for failure to obtain credit counseling. The judge's frustration with the new bankruptcy law boiled over in his concluding paragraphs, "Apparently, it is not the individual consumers of this country that make the donations to the members of Congress that allow them to be elected and re-elected and re-elected and re-elected. The Court's hands are tied. The statute is clear and unambiguous. The Debtors violated the provision of the statute outlined above and are ineligible to be Debtors in this case. It must, therefore, be dismissed . . . . Congress must surely be pleased."[14]

I am not naively going to suggest that BAPCPA be repealed in its entirety. Although repeal would be of enormous benefit to the middle class Americans that make

[13] *In re* Jones, No. 06-33790 (Bankr. S.D. Tex. Oct. 20, 2006) (available at 2006 WL 3020477).
[14] *In re* Sosa, 336 B.R. 113, 115 (Bankr. W.D. Tex. 2005).

this country work, such an option appears politically infeasible. Rather than walk away from a system where no change seems possible, Congress could start with one small change that would help the working class Americans who find themselves in financial trouble. That change should be to increase the discretion of the bankruptcy judges to excuse credit counseling when it would serve no useful purpose. The credit counseling lasts only one hour on average and, in six of every seven cases, is delivered over the telephone or over the Internet.[15] Given the small amount of actual counseling that occurs, a strong case can be made the credit counseling requirement should be repealed altogether. It would be a small change that would restore the bankruptcy system back on the path to rationality. It would be a small change that would prevent bankruptcy judges from having to apologize to debtors for having to enforce a law that makes no sense. It would be a small change but a meaningful one for middle-class Americans.

Again, thank you for allowing me to address you today.

[15] National Foundation for Credit Counseling, "Consumer Counseling and Education Under BAPCPA," at 8-9 (Oct. 16, 2006).

JUDICIAL CONFERENCE OF THE UNITED STATES

WASHINGTON, D.C. 20544

THE CHIEF JUSTICE
OF THE UNITED STATES
Presiding

LEONIDAS RALPH MECHAM
Secretary

April 6, 2006

Honorable Charles E. Grassley
United States Senate
135 Hart Senate Office Building
Washington DC 20510-6276

Honorable Jeff Sessions
United States Senate
335 Russell Senate Office Building
Washington DC 20510-0104

Dear Senators Grassley and Sessions:

Chief Justice John G. Roberts asked me to respond to your letter of March 13, 2006, which raises concerns about provisions in certain Interim Bankruptcy Rules adopted by the courts and Official Forms promulgated by the Judicial Conference in August 2005, implementing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

The Act's general effective date of 180 days after enactment did not provide sufficient time to promulgate Official Forms and national rules under the exacting scrutiny procedures provided under the Rules Enabling Act, 28 U.S.C. §§ 2071-2077. The Judicial Conference's Advisory Committee on Bankruptcy Rules was compelled to engage in an intensive effort beginning in April 2005 to develop Interim Rules and amended or new Official Forms within the short time provided under the Act. The advisory committee worked closely with the Department of Justice's Executive Office for United States Trustees. It also consulted with experts in the area, including persons who participated in the drafting of the legislation and representatives of creditors' and debtors' organizations. The Official Forms and Interim Rules implementing the Act that took effect in October 2005 have been well received. The advisory committee continues to consider making appropriate adjustments to them based on the experiences of the public, bench, and bar.

The advisory committee recognizes the inherent limitations of the abbreviated rulemaking process that was used in promulgating the Official Forms and Interim Rules in August 2005. In accordance with the Rules Enabling Act rulemaking process, the advisory committee is proposing new and amended Federal Rules of Bankruptcy Procedure that are largely based on – and intended to replace – the Interim Rules. The proposed rules will be published for a six-month public-comment period in August 2006. The Official Forms that are in effect today are also being published for comment together with the proposed rules. Through this process, persons interested in the bankruptcy process can offer their comments and suggestions to the advisory committee for its consideration. At the same time, the advisory committee is also proposing amendments to an Interim Rule and to several Official Forms that require immediate attention to take effect in October 2006.

The advisory committee will consider all comments submitted on the Official Forms and amended rules at its spring 2007 meeting. The Judicial Conference's Committee on Rules of Practice and Procedure at its June 2007 meeting will consider any revisions proposed by the advisory committee in light of the public comment. If approved by the Judicial Conference, the amended rules would be transmitted to the Supreme Court and later to Congress for approval, with a targeted effective date of December 1, 2008. Some of the proposed revised Official Forms would take effect in September 2007, while others would take effect in December 2008 to coincide with the effective date of the proposed rule amendments.

Among the comments submitted from the bench, bar, and public on the revised and new Official Forms and Interim Rules were concerns first raised by Senator Grassley in his letter of August 18, 2005. (Two of the senator's concerns are again raised in the March 13, 2006, letter.) The advisory committee considered these concerns at its March 2006 meeting. After a substantial discussion, it concluded that a motion to dismiss must be pleaded with particularity to comply with the general standards applicable to all motions filed in a bankruptcy case. In addition, the motion to dismiss must be pleaded with some specificity to allow the debtor to respond with a proper answer. The advisory committee also determined that amending the rules or Official Forms to reiterate provisions in the Bankruptcy Code governing the effect of an attorney's signature on a pleading is not necessary or appropriate, because the statutory requirement is self-executing. For these and other reasons stated in the enclosed September 15, 2005, response to Senator Grassley, the advisory committee has deferred revising the Official Forms or rules relating to these concerns. It will study the matter further during the public-comment period.

Your letter also raises two new concerns with Official Forms B22A-C, the means-testing forms. The advisory committee will consider these concerns as part of its responsibility to review all comments submitted on the Official Forms when they are published for comment later this year. The advisory committee's reporter, Professor Jeffrey Morris, was asked to review these concerns. His detailed reply is enclosed. As a preliminary matter, he concludes that these further the possibility of adding a provision governing the effect of an attorney's signature on a pleading, a proposal the committee earlier declined to adopt.

The first concern questions whether the Official Forms satisfy the statutory requirement to show "how each such amount [income and calculations that determine whether a presumption of abuse arises] is calculated." All individual chapter 7 debtors are required to report their income on Official Form B22A, as required under § 707(b)(2)(C) of the Bankruptcy Code. There are no exemptions. If a debtor's income level alone is equal to or less than the applicable median family income without taking into account authorized deductions, however, no presumption of abuse is established and there is no need for further calculations. The Act specifically states that no motion may be brought under § 707(b)(2) if the debtor has an income equal to or less than the applicable state median. In these cases, debtors are excused from listing authorized expense deductions, which can only reduce their income level and strengthen the grounds showing that there is no abuse. Accordingly, if the income level is equal to or less than the applicable median family income, no further calculations are necessary and the form does not require it, which is consistent with the statutory requirements. Importantly, a debtor must still report in detail all income and expenses on separate Schedules I and J. Furthermore, § 521(a)(1)(B) of the Bankruptcy Code requires the debtor to file copies of payment advices and a statement of monthly income with the court. Interim Rule 4002(b)(2)(A) and Official Form 22A (lines 2-10) implement those requirements.

The second concern suggests a possible double counting of a debtor's mortgage expenses as part of the means-testing calculations. Each debtor is entitled to a housing and utilities allowance as determined by the IRS. But because the debtor is also entitled to a deduction for actual mortgage payments, the means-testing form (Official Form B22A) reduces the IRS allowance by the actual mortgage payment to prevent double counting. The form is consistent with the statutory requirement, giving effect both to a debtor's mortgage payments actually made and the general housing and utilities allowance without double counting. As noted, the enclosed reporter's memorandum fully addresses these concerns.

The advisory committee is looking forward to public comments on the Official Forms, including the means-testing forms, and proposed rules amendments that were based on the Interim Rules and used by the courts since October 17, 2005. The experiences of the bench, bar, and public with these Official Forms and Interim Rules will inform the committee's consideration of whether any further changes are needed. In this context, the advisory committee will examine afresh any new suggestion or comment submitted on the Official Forms and Interim Rules that might implicate a matter that the committee had earlier addressed, including the concerns raised in your letter.

Honorable Charles Grassley and Jeff Sessions
Page 4

The advisory committee appreciates your comments. If you or your staff have any questions on these matters, please contact Peter G. McCabe, Secretary, Committee on Rules of Practice and Procedure, at 202-502-1800.

Sincerely,

Ralph Mecham

Leonidas Ralph Mecham
Secretary

Enclosures

cc: Chief Justice John G. Roberts
Honorable David F. Levi
Honorable Thomas S. Zilly
Honorable Arlen Specter
Honorable Patrick J. Leahy
Honorable Orrin Hatch

COMMITTEE ON RULES OF PRACTICE AND PROCEDURE
OF THE
JUDICIAL CONFERENCE OF THE UNITED STATES
WASHINGTON, D.C. 20544

DAVID F. LEVI
CHAIR

PETER G. McCABE
SECRETARY

CHAIRS OF ADVISORY COMMITTEES

CARL E. STEWART
APPELLATE RULES

THOMAS S. ZILLY
BANKRUPTCY RULES

LEE H. ROSENTHAL
CIVIL RULES

SUSAN C. BUCKLEW
CRIMINAL RULES

JERRY E. SMITH
EVIDENCE RULES

MEMORANDUM

TO: **HON. THOMAS ZILLY**
CHAIR, ADVISORY COMMITTEE ON BANKRUPTCY RULES

FROM: **JEFF MORRIS, REPORTER**

RE: **COMMENT SUBMITTED BY SENATORS GRASSLEY & SESSIONS**

DATE: **MARCH 24, 2006**

On March 13, 2006, Senators Chuck Grassley and Jeff Sessions sent a comment on the Bankruptcy Rules to Chief Justice Roberts. Their comment, logged into the Interim Rules Comment Docket as 05-BR-033, raises several issues regarding the rules under consideration by the Committee for recommendation to the Standing Committee for publication in August 2006.

OFFICIAL FORM B22A-MEANS TEST

The Senators' first issue relates to the operation of the Means Test Form in chapter 7 cases. Official Form B22A, line 15, provides that if the debtor's annualized monthly income (line 13) is less than the applicable median family income (line 14), then the debtor is instructed not to complete parts IV through VII of the Form. The Senators urge that the Form be revised to "require all debtors to provide income figures." However, the Form does require all debtors to provide the income information. Parts V, VI, and VII that below-median-income debtors need not complete relate only to the recognition of expenses and the calculation of the § 707(b)(2) presumption based on those expenses. Part IV of the Form deducts from the annualized current income any amounts of a non-filing spouse that are not contributed to the household. The Form does not permit debtors to avoid setting out their income in full. Consequently, the Form seems to do what the senators ask that it should do.

Their letter also notes that Official Form B22A "directs the debtor not to provide the needs-based calculations if the debtor's income is below the state median income." This is an accurate statement regarding Official Form B22A. The Advisory Committee, with the concurrence of representatives of the United States Trustee Program, considered on several occasions whether the Form should require all debtors to complete the entire Form, including the portion of the Form that sets out the debtor's living expenses. After due consideration, the Committee concluded that it was unnecessary for debtors to complete those portions of the Official Form. The reason for excepting them from this requirement was that § 707(b)(7) specifically prohibits any party, including the court, from moving to dismiss a debtor's case as an abuse under § 707(b)(2) if the debtor's annualized current monthly income is less than the applicable State median income. Thus, debtors would be required to complete a Form to generate information for which there is no use.

Additionally, the Senators' letter suggests that the Congress and the Senate Judiciary Committee rejected any exemption from the filing requirements. While this portion of the letter seems to be directed entirely towards income reporting, I have already noted that there is no income reporting exception in Form B22A. If the letter is intended to suggest that Congress intended no exemption for any debtor from reporting the living-expense deductions, I still believe that the Committee's action in exempting debtors whose income is below the State median income from this obligation is consistent with both § 707 and the intent of Congress.

Section 707(b)(2)(C) requires that a debtor's schedule of income and expenditures state "the debtor's current monthly income, and the calculations that determine whether a presumption arises under" § 707(b)(2). Since no party can bring a motion based on the presumption of abuse if the debtor's income is below the applicable State median income, the calculation that is "necessary" to determine whether the presumption applies is the debtor's annualized current monthly income if that number is less than the applicable State median income. I believe this is an appropriate interpretation of § 707(b)(2)(C), and I believe also that it is consistent with the intent of Congress, as best I can determine it.

For example, in the floor debate in the Senate on March 8, 2005, Senator Sessions, in response to Senator Durbin, stated that "I said in my remarks that if you make below median income, you are not subject to the means test. I guess that technically may be a misspeaking. What I meant was you are not required to pay anything back under chapter 13. He said, well, why fill out the forms? Well, you fill out the forms to see whether your income falls below the median income in America; that is why you fill out the forms." 151 Cong. Rec. at S2219-20 109th Cong. 1st Sess., March 8, 2005). At one point, Senator Sessions thereafter yielded the floor to Senator Durbin who asked "if I have done all of the basic filing [Schedules of Assets & Liabilities] and I disclosed my monthly income and I am below median income, than I do not have to fill out the forms for the Means Test; it does not apply to me....is that the Senator's understanding of what this law says?" Senator Sessions replied "I think that is my understanding of it." Id. at S2221.

Senator Durbin also introduced Amendment No.110 which would have amended § 707(b)(7) to provide in part that "a debtor described in this paragraph need only provide the calculations or other information showing that the debtor meets the standards of this paragraph." Senator Durbin asserted that the amendment should have been non-controversial because it was consistent with the positions that supporters of the bill had taken throughout its consideration. That is, the safe harbor provision of the means test prevents it from adversely impacting low income debtors. In response, Senator Sessions stated that "the issues that he [Senator Durbin] raises are really covered by the bill. If someone, anyone, is disabled and they have a continuing extra medical expense, that would be considered in whether or not they would ever have to pay any of their debts back. If their income is below median income, they would never be required to pay their debts back. All they would have to do is introduce some evidence from their pay stubs or their income tax, what their income is. Certainly we have the right to ask that before we discharge, wipe out, eliminate all debts, as people do when they come into bankruptcy." Id. at S2221. Further, Senator Hatch opposed Amendment 110 stating that "If you are below the State median income, you are not subject to the means test. It is as simple as that." Id.

It is certainly consistent with this legislative history to conclude that Congress determined that a specific amendment excepting all debtors from the obligation to complete the living expense calculations for the Means Test if their income is below the state median income was unnecessary. The Advisory Committee, with the concurrence of the United States Trustee Program, has worked from this understanding of the legislative history in its efforts to discern the Congressional intention. Furthermore, the Committee assumed that Congress did not intend to make debtors engage in a disclosure exercise that would produce information that could not be used to support a motion to dismiss the case under § 707(b)(2).

HOUSING EXPENSE AND MORTGAGE PAYMENTS

In § 707(b)(2)(A)(ii)(I), the debtor is directed to deduct the "applicable monthly expense amounts specified under the National Standards and Local Standards...issued by the Internal Revenue Service for the area in which the debtor resides." That section further provides that "notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts." This creates a potential conflict in that the IRS National Standards and Local Standards include a mortgage or rental expense among those standards. In fact, the Committee has received comments urging that debtors be allowed to deduct both the actual mortgage payment and the IRS housing expense under § 707(b)(2)(A)(iii). The Committee rejected these arguments as creating a situation in which debtors could "double dip" in a manner that did not seem to the Committee to be consistent with the intent of Congress even if a statutory construction argument could be asserted in support of such a position. Rather, the Committee concluded that Congress had intended to establish the IRS housing standards as the cap for those housing expenses. That is, a debtor could claim no more than the amount of the allowed housing expense even if their current rent or mortgage payment exceeded that figure.

The Committee's study of the Act led to the conclusion that it was the intent of Congress to establish relatively uniform standards for the living expenses of debtors. Specifically, the statute provides that "the debtor's monthly expenses **shall be** the debtor's applicable monthly expense amounts **specified under the National Standards and Local Standards**" of the IRS. In the Committee's view, this statutory directive means that the debtor must use the appropriate IRS living allowance amount in calculating the means test. Moreover, using these expense numbers in that manner promotes uniformity within the bankruptcy system. That uniformity would be disrupted if the housing expenses of debtors varied from one debtor to another even if the debtors' income, family size, and location were the same. Thus, the Committee concluded that the IRS housing expense was intended by Congress to be available to all debtors similarly situated to the same extent.

Limiting debtors to lower amounts for housing would also discourage debtors from seeking out more affordable housing since their allowed expenses would be higher if they lived in more expensive quarters. We did not believe that Congress intended to encourage debtors to seek more expensive housing than they might otherwise select. For example, for a debtor with a family of four in Des Moines County, Iowa, the IRS local living allowance totals $1038. Those figures are broken into mortgage/rent and non-mortgage/rent expenses of $581 and $457, respectively, for use in the means test. If a debtor resides in a home or apartment for which the mortgage or rental payment is less than $581, there would be an incentive for that debtor to move to a more expensive residence in order to take advantage of a higher living allowance under the means test if that test were applied as proposed by Senators Grassley and Sessions. The Committee did not believe that Congress intended to include such incentives to maximize the living allowances under the means test in this manner.

Two other examples illustrate the operation of the provision. If a debtor chooses to purchase an inexpensive home that requires significant repairs, he or she would be penalized under the Senators' proposed application of the statute because the debtor would be restricted to the same non-mortgage expense allowance as a person who purchased a more expensive home with less need for repairs. Similarly, a debtor who opts to live in a very cramped apartment in order to save money to cover the costs of parochial school for his or her children would be penalized under the proposal. The Committee concluded that Congress did not intend to impose these costs on debtors, nor did it intend to provide incentives for debtors to increase their mortgage or rental costs to take greater advantage of the Code. Instead, the uniform application of the IRS Standards leaves these lifestyle choices to the debtors rather than imposing an obligation on the courts to make decisions about the propriety of any particular expenses being allowed or disallowed.

PLEADING WITH PARTICULARITY FOR MOTIONS TO DISMISS

Section 707(b) contains another ground for dismissal of the case besides the debtor's failure to meet the means test. Under § 707(b)(3), a case may be dismissed if the debtor filed the petition in bad faith or if the totality of the circumstances demonstrates abuse. Unlike the means test set out in § 707(b)(2), the grounds for dismissal under § 707(b)(3) are neither precise nor based on any arithmetic calculation. Instead, they address more generalized grounds for dismissal of the case. It would be impossible to imagine every factual scenario that might be presented which warrants dismissal of the case under § 707(b)(3), and the statute offers no particular directive. It leaves to the courts the determination of whether the particular circumstances of the case warrant dismissal.

A party in interest seeking dismissal of the case under § 707(b)(3) must necessarily have some basis for making the motion. Interim Rule 1017(e)(1) requires that the party filing the motion "state with particularity the circumstances alleged to constitute abuse." Requiring the movant to state the grounds with particularity is consistent with Bankruptcy Rule 9013, which has for many years required that motions "state with particularity the grounds therefor." Furthermore, because the statutory grounds for dismissal under § 707(b)(3) are intentionally very broadly stated, the Committee concluded that permitting these motions to be filed with only the most general allegations would likely cause every debtor to respond to the motion with a responsive motion for a more definite statement. The Committee concluded that reminding parties that file motions under § 707(b)(3) that Rule 9013 requires their motions to state the grounds for relief with particularity would streamline the process and avoid unnecessary delays in the resolution of these important matters. This requirement places no additional burdens on creditors seeking to obtain the dismissal of the case under § 707(b)(3). Rule 9013 already requires them to state their grounds with particularity, and the inclusion of that requirement in Rule 1017(e)(1) simply serves as a reminder to creditors of that obligation.

ATTORNEY CERTIFICATIONS

Senators Grassley and Sessions correctly note that § 707(b)(4)(C) & (D) provide that an attorney's signature "shall constitute a certification" regarding the attorney's investigation of the underlying facts contained on the petition, pleadings, or written motions. The Interim Rules do not include any provision to implement these subparagraphs of § 707(b). The Committee did not propose any such provision because the language of the statute is self executing. The Committee has generally operated on the assumption that a rule should not simply restate the statute, so statutory provisions that are self executing have no counterparts in the Bankruptcy Rules. For example, § 521(a)(5) requires the debtor to "appear at the hearing required under section 524(d)." Neither Bankruptcy Rule 4002 (Duties of Debtor) nor Rule 4008 (Discharge and Reaffirmation Agreement) includes that specific directive because the statutory language is sufficient.

Although the statute is self executing with regard to this issue, I would recommend that the Committee consider adding a provision to the rules that specifically restates the effect of these sections. Such a provision might be included as a part of Rule 9011, a rule that will be under consideration by the Committee's Subcommittee on Attorney Conduct over the next several months. The Committee would need to study the issue to determine the proper application of these requirements in the larger context of the Bankruptcy Rules. The certifications governed by § 707(b)(4) apply only in chapter 7 cases. Rule 9011 applies in all chapters. The Committee needs to study the impact of a chapter-specific certification such as that set out in § 707(b)(4). Among the issues that they must consider is whether Congress intended this standard to apply only in chapter 7 cases, anticipating that a different standard would apply in cases under the other chapters of the Code. Moreover, the Committee must evaluate the effect of § 707(b)(4) when the case is converted to or from chapter 7. Given that the obligation is placed on attorneys in chapter 7 cases even in the absence of any rules to that effect, the Committee did not perceive a pressing need to amend Rule 9011 or propose any new rule to implement those provisions of the Code. More careful study is now possible without the time pressures presented by the 2005 Amendments, which required a wide range of procedural rules to implement that Act.

The comments of Senators Grassley and Sessions relate to the Interim Rules proposed by the Committee and, ultimately, the Judicial Conference for adoption by local courts. At this time, the Committee is reconsidering those rules for recommendation to the Committee on Rules of Practice and Procedure for publication in August 2006. After publication, interested parties will have six months to comment on the proposals. Those comments will be considered by the Advisory Committee, the Standing Committee and the Judicial Conference, in order, once they are made and prior to any recommended adoption of the Rules by the Supreme Court. The Advisory Committee certainly will be considering the comments of Senators Grassley and Sessions very carefully in its review of the proposed rules.

STATEMENT OF EUGENE CRANE, PRESIDENT OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES, ON BEHALF OF THE ASSOCIATION

On behalf of the National Association of Bankruptcy Trustees (NABT), I would like to thank the Subcommittee for the opportunity to comment on the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2004 (the "ACT"). NABT represents the interests of the over 1,200 private panel Trustees who administer cases filed under Chapter 7. Panel Trustees have an important role in the administration of the existing provisions as well as the new provisions of the ACT and we are committed to making the ACT work. Our comments today are focused on issues relating to the implementation of the ACT.

Chapter 7 panel Trustees are charged with carrying out the provisions of the Bankruptcy Act (ACT) and are appointed in every chapter 7 case at the time of the filing as bonded fiduciaries. Trustees, conduct the required examinations of debtors (the 1978 Amendments assigned this task, formerly performed by bankruptcy judges, to allow only disputed and contested litigable matters to be heard and disposed of by the judiciary). The vast majority of debtors never appear before a judge and have their bona fides confirmed, and their asset/liabilities determined by a trustee. Trustees have an obligation to secure relief for honest but unfortunate debtors and to investigate filings for abuse, wrongdoing and improper filings as well as to protect the interests of all parties to a proceeding and, pursue and reduce to cash all assets available to insure an equitable distribution of assets recovered to all creditors.

The NABT is committed to maintaining the effectiveness and fairness of the system and to that end we believe there are several areas of the law that congress may want to look at with an eye toward implementation, in appropriate instances, of the provisions of the law to allow trustees to effectively perform their duties and achieve the intended legislative purposes.

ACT PROVISIONS

1. Notification of Child Support Claimants

Sec. 704(a)(10) imposes a new notice requirement mandating service of notices at filing and at discharge to all agencies and persons to whom a support obligation is due. NABT is at work developing methods to implement the new §704(a)(10), through which child support claimants will be notified of their rights as creditors in Chapter 7 classes of Debtors from whom a support obligation is due. We envision that this provision will, with the cooperation of the EOUST, be effectively implemented through a series of procedures and notices provided by the panel

Trustee throughout the case. We believe that, through this process, claimants owed domestic support obligations can and will be made aware of the options available to them to enforce Court-ordered support.

2. Additional Information Required of Debtors

NABT believes that the additional information which is required to be furnished to the Trustee (and others), prior to the first meeting of creditors, will aid in the identification and liquidation of assets for the benefit of creditors. We are actively working on methods of delivery which allow us to effectively utilize the volume of information which will be provided to us by each Debtor. Additionally, we will attempt to insure that this information will remain confidential, and be used solely for the purposes intended by the statute.

Review of this required information will serve to insure that all assets are disclosed and, where appropriate, applied to the payment of creditors' claims. It will also, in many cases, more adequately define the Debtors' circumstances, which will allow the panel Trustee to perform the job more effectively.

3. Waiver of Filing Fee

Amended 28 U.S.C. §1930(f)(1) provides for the waiver of Chapter 7 case filing fees for individuals with "income less than 150 percent of the income official poverty line" if the Court determines the individual is unable to pay the fee in installments.

Trustees are paid compensation of $60.00 for administering cases in which no assets are available for liquidation. The funding for these fees is derived from the Chapter 7 case filing fee [see 11 U.S.C. §330(b)(1)] and Miscellaneous Bankruptcy Court Fees prescribed by the Judicial Conference of the United States [see 11 U.S.C. §330(b)(2)].

There is no provision for payment to Trustees where the filing fees are waived. A statistical survey shows that the number of *informa pauperis* cases where filing fees are waived ranges as high as 9.78% in some jurisdictions. Trustees are now faced with a reduction in compensation for their work in administering those cases. This apparent oversight needs to be corrected and a system established to provide adequate funding for payment of Trustee fees in these cases.

4. Protecting Patient Records

The ACT adds a new §351 to the Code that provides a procedure for notification and disposal of patient records in cases where the Trustee does not have sufficient funds to pay for the storage of records in the manner required under applicable federal or state laws. The ACT fails to take into account that in some circumstances Trustees will lack sufficient funds to comply with the procedure established under

§351. For example, under §351 Trustees are required to undertake various costly actions including: storing records for one year; publishing a notice in one or more appropriate newspapers; notifying every patient and appropriate insurance carrier by mail; communicating by certified mail with each appropriate federal agency; and destroying the records. It is estimated that these costs could range anywhere from $3,500.00 in smaller cases (500 or fewer patients) to $35,000.00 in medium cases (10,000 patients) and higher in large cases (up to 100,000 patients and more). If Trustees do not have the funds to pay for the storage and notices required in §351, patient records may not be administered properly and could be lost.

The problem can be corrected by allowing a court in no asset or limited asset cases, upon motion of the Trustee, to direct the person or persons responsible for maintaining, storing or disposing of patient records under state law, prior to the appointment of the Trustee, to resume the responsibility of preserving the records. In such circumstances, the responsible party would be directed, by court order, to perform the functions required under §351.

5. Payment in Converted Cases

The ACT was intended to provide a mechanism and payment schedule for Chapter 7 Trustees to receive compensation in cases converted or dismissed pursuant to 707(b). The ACT included changes to §1326(b) of the Code specifying the payment schedule to be applied if Trustees are allowed compensation due to the conversion or dismissal of case under §707(b). These changes are inadvertently ineffective, however, unless §326 of the Code is also modified to provide for Trustee compensation in converted or dismissed cases. Under current judicial interpretations of §326, Trustees have been denied compensation in cases converted or dismissed under §707(b) because Trustees have not actually disbursed or turned over monies to parties in interest in such cases (which that statute requires as a prerequisite).

The problem can be corrected by adding a new subsection (e) to §326 to provide that the Court may allow reasonable compensation for services rendered by the Trustee, if the Debtor in a Chapter 7 case commences a motion to dismiss or convert and such motion is granted, or if the case is converted from Chapter 7 to another chapter, and the actions or positions of the Chapter 7 Trustee were a factor in the conversion of the case. Since cases are most often converted from Chapter 7 to 13 without the processing of a formal §707(b) motion (a threat of a motion is often sufficient), Trustees should be allowed compensation if their actions or positions were a factor in the conversion of the case (i.e., discovery of undisclosed or undervalued assets).

Trustees have and will continue to direct those Debtors who have an ability to repay some or all of their debts into a Chapter 13 repayment plan. It was the intent of Congress to reward us for these efforts, and encourage our continued vigilance.

6. **Avoiding Automatic Dismissal in Asset Cases**

The ACT modifies §521 of the Code to compel an automatic dismissal of cases where certain information is not timely provided. If a Debtor does not reaffirm or surrender collateral within 45 days after the first meeting of creditors, the automatic stay under §362(a) is terminated and the property "shall no longer be property of the estate," even if there is equity in that property for the benefit of the estate.

The automatic dismissal language raises concerns insofar as it renders valuable property "no longer property of the estate" and places it beyond the reach of the Trustee or the court. Trustees may not be able to determine whether there are unencumbered non-exempt assets to administer by the deadlines imposed under §521, in part, because debtors who are dilatory in reaffirming/surrendering are often unresponsive to trustees. Although trustees may ask for extensions of the §521 deadlines, circumstances may prevent the trustee from having sufficient information to support a motion for an extension of time.

7. **Increase in "No Asset Fee"**

Under the present law, Trustees receive $60.00 for administering Chapter 7 cases in which no assets are liquidated. The last increase in this Trustee compensation occurred in 1994, when the fee was raised from $45.00 to $60.00.

The ACT imposes new, and more duties on Chapter 7 Trustees. There are significantly more documents to review, notification of specific classes of creditors (child support claimants), a higher degree of scrutiny of th true economic status of individual Debtors (review of income tax returns and payment advices prior to conducting a Section 341 meeting of creditors), and more statistical reporting in order to allow a monitoring of the effectiveness of the system.

NABT is actively involved in educating Trustees as to implementation of the ACT and fulfillment of these new requirements. It is the statutory duty of Chapter 7 Trustees to acclimate themselves to the new system, so that they can continue to properly administer bankruptcy cases.

Sixty dollars (the fee for the last 11 years) is not fair and adequate compensation to administer a bankruptcy case. Unless Trustees are fairly compensated for their services, the bankruptcy system will be unable to retain and attract qualified Trustees, which will negatively impact the functioning of the entire system. There has been bipartisan support for raising Trustee compensation from $60.00 to $100.00 for no asset cases. We urge the Congress to act on this increase without delay.

NATIONAL BANKRUPTCY CONFERENCE
A Voluntary Organization Composed of Persons Interested in the Improvement of the Bankruptcy Code and Its Administration

<u>MEMORANDUM</u>

DATE: December 18, 2006

TO: Honorable Jeff Sessions, Chair
Subcommittee on Administrative Oversight and the Courts
Committee on the Judiciary

Honorable Charles Schumer, Ranking Member
Subcommittee on Administrative Oversight and the Courts
Committee on the Judiciary

FROM: Sally S. Neely
Co-Chair, Committee on Legislation

RE: <u>"Oversight of the Implementation of The Bankruptcy Abuse Prevention and Consumer Protection Act"</u>

The National Bankruptcy Conference hereby submits the Written Statement of Sally S. Neely and Ralph R. Mabey, the Co-Chairs of its Committee on Legislation, in connection with the hearing held by the Subcommittee on Administrative Oversight and the Courts of the Senate Committee on the Judiciary on December 6, 2006, on "Oversight of the Implementation of The Bankruptcy Abuse Prevention and Consumer Protection Act."

We encourage the Subcommittee's careful consideration of the important issues raised by the implementation of BAPCPA.

Thank you.

cc (w/enc.):
The Hon. Joseph R. Biden, Jr.
The Hon. Sam Brownback
The Hon. Tom Coburn
The Hon. John Cornyn
The Hon. Mike DeWine
The Hon. Richard J. Durbin
The Hon. Russ Feingold
The Hon. Dianne Feinstein
The Hon. Lindsey O. Graham
The Hon. Charles E. Grassley
The Hon. Orrin G. Hatch
The Hon. Edward M. Kennedy
The Hon. Herbert H. Kohl
The Hon. Jon L. Kyl
The Hon. Patrick J. Leahy
The Hon. Arlen Specter

PMB 124, 10332 MAIN STREET • FAIRFAX, VA 22030-2410 • TEL: 703-273-4918 • FAX: 703-802-0207
E-mail: info@nbconf.org • Website: www.nationalbankruptcyconference.org

Written Statement
United States Senate Committee on the Judiciary
Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act

Ralph R. Mabey
Sally S. Neely
Co-Chairs, Committee on Legislation
National Bankruptcy Conference

We are Co-Chairs of the Committee on Legislation of the National Bankruptcy Conference ("NBC").[1] We read with interest the testimony provided by the live witnesses at the hearing on "Oversight of the Implementation of the Bankruptcy Abuse Prevention Act" held by the Senate Committee on the Judiciary's Subcommittee on Administrative Oversight and the Courts on December 6, 2006.

The NBC concurs with the witnesses that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA" or the "Act") contains errors that should be promptly addressed in a "technical corrections bill." In fact, there are numerous and material drafting errors that are causing or will, unless corrected, surely cause uncertainty and wasteful and expensive litigation as to the meaning and application of various provisions of the Bankruptcy Code as amended by the Act. While some of the errors raise significant policy issues that members of Congress may also wish to consider, many important corrections can be made without major policy ramifications.

Through its members, the NBC monitors drafting and related issues with respect to BAPCPA as they arise in cases or are otherwise detected, and continues to compile a list of those issues that should be addressed. Thus, the NBC is well-situated to assist Congress to identify and correct errors in BAPCPA. We are ready to do so on a timely basis, with either technical or policy issues.

Several of the witnesses at the hearing informed the Subcommittee of serious issues raised by drafting problems with BAPCPA, with particular focus on consumer bankruptcy cases under chapters 7 and 13. We point out below another sample of additional technical errors in BAPCPA:

---

[1] The NBC is a voluntary, non-profit, self-supporting organization of approximately 60 lawyers, law teachers and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. The primary purpose of the NBC is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws. The NBC has been working cooperatively with Congress on bankruptcy legislation since the 1930's. A fact-sheet and information about our members is attached to this letter.

- Section 1127(f)(1)[2] is part of BAPCPA's amendments relating to individual chapter 11 cases. It provides that "Sections 1121 through 1128 and the requirements of section 1129 apply to any modification under subsection (a)." The reference to "subsection (a)," which deals solely with pre-confirmation modifications, is incorrect, as BAPCPA provides for amendment of individual chapter 11 plans at any time before completion of payments. The reference should be to "subsection (e)," which deals with modification of individual chapter 11 plans. Further, section 1127(e) provides no standard against which to judge proposed modifications, even though section 1141(d)(5)(B) permits an early discharge (prior to full payment under the plan) if creditors have received at least what they would have received in chapter 7 and "modification of the plan under section 1127 is not practicable." In addition, section 1141(d)(5)(C) fails to state what consequences follow (presumably, denial of discharge) if the court makes the requisite findings related to section 522(q), unlike its counterparts, sections 727(a)(12)(B), 1228(g) and 1328(h).

- Section 521(i)(1) provides that, in a voluntary chapter 7 or chapter 13 case, if the debtor fails to file all of the information required under section 521(a) within 45 days after the petition date, the case shall be automatically dismissed on the 46th day. By contrast, section 521(i)(2) permits a party in interest to request the court to enter an order dismissing a case described in paragraph (1) – an act that would be inconsistent with automatic dismissal.

- Section 1112(b)(4) sets forth examples of "cause" based on which a chapter 11 case is to be converted to chapter 7. Currently, the conjunction "and" is used to link the itemized causes. It should be changed to "or," to avoid the interpretation that all of the itemized causes must exist. As section 102(5) makes clear, "or" is not exclusive.

- Section 522(p) limits the homestead exemption with respect to property acquired within approximately 3 1/3 years prior to bankruptcy. This limitation applies to state homestead exemptions available to a debtor "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law." Since some states require the use of their exemption system in bankruptcy, and do not permit a debtor to elect either the state or federal exemption system, some courts have held that the section 522(p) limitation does not apply to debtors in such states. It does not appear that this was Congress's intent.

- Section 362(d)(4) provides for relief from the automatic stay for a creditor secured by an interest in real property "if the court finds that the filing of the petition was part of a scheme to delay, hinder, and defraud creditors . . . ." Elsewhere in the Bankruptcy Code (e.g., section 548(a), dealing with fraudulent transfers and obligations), the phrase "hinder, delay, or defraud creditors" is used, and has been interpreted to capture conduct that delays or hinders or defrauds

[2] Section numbers used herein refer to provisions of the Bankruptcy Code, 11 U.S.C. § 101 et seq., as amended by BAPCPA.

creditors. By contrast, use of "and" in section 362(d)(4) implies that the conduct must delay and hinder and defraud creditors. It does not appear that this was Congress's intent.

- Section 546(c) deals with reclamation claims of sellers that have sold goods to insolvent debtors prepetition. While the BAPCPA amendment appears to de-couple reclamation in bankruptcy from compliance with otherwise applicable nonbankruptcy law on the subject, it fails to address many issues resolved by nonbankruptcy law, leaving much uncertainty as to if and when such law should be applied in bankruptcy. In addition, it is not clear under section 546(c)(2) whether a seller that gives notice in the manner prescribed, but is not able to reclaim for some other reason (such as the existence of a senior secured claim), is still entitled to an administrative claim if it otherwise qualifies under section 503(b)(9). Further, the cross-reference in the opening phrase of section 546(c)(1) to section 507(c) is in error, as section 507(c) deals with claims of governmental units arising from erroneous tax refunds or credits – a subject that has nothing to do with reclamation. It appears that the proper cross-reference is to section 507(b), which deals with adequate protection of secured creditors, and is pertinent to the rights of reclaiming sellers.

- Section 103(k)(1) lists sections in new chapter 15 that apply to all bankruptcy cases, not just those that are filed under chapter 15. However, the list is incomplete, and should be amended to add sections 1523 through 1529, 1531 and 1532.

These are only a few examples of technical problems with BAPCPA. In fact, as noted above, there are numerous instances of drafting errors in BAPCPA, which have resulted and will continue to result in confusion, conflicting interpretations and unintended consequences.

Members of Congress or their staff should feel free to contact us for assistance from the NBC with respect to BAPCPA or any other matters relating to bankruptcy. We stand ready to help.

Mr. Ralph R. Mabey
(801) 257-7976
rmabey@stutman.com

Ms. Sally S. Neely
(213) 896-6024
sneely@sidley.com

TESTIMONY OF

U.S. BANKRUPTCY JUDGE RANDALL J. NEWSOME

BEFORE THE SUBCOMMITTEE ON

ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE U.S. SENATE COMMITTEE ON THE JUDICIARY

DECEMBER 6, 2006

2:30 P.M.

Mr. Chairman and distinguished members of this committee, I am honored to appear before you to discuss the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (hereafter referred to as BAPCPA). By way of introduction, I have been a United States Bankruptcy Judge in the Northern District of California since May of 1988, and chief judge of the district since January of 2004. From October, 1982 until May, 1988, I was a bankruptcy judge in the Southern District of Ohio. From October of 1998 until October of 1999, I was the president of the National Conference of Bankruptcy Judges. However, I want to make it clear from the outset that I am appearing before this Subcommittee representing myself only, and not the NCBJ or any of its members.

When I appeared before the full U.S. Senate Committee on the Judiciary on February 8, 2001, I made the following statement concerning S. 220, a bill substantially similar to BAPCPA:

> The stated intent of the consumer provisions of S. 220 was to shepherd those who could repay some of their debts from chapter 7 into chapter 13. But the effect of. . .the bill is to make it more difficult for anyone to obtain bankruptcy relief of any kind. Notwithstanding all of the hurdles and pitfalls, it is doubtful that many people will be deterred from filing. The financial condition of the overwhelming majority of debtors is such as to leave no other viable option.

I believe this statement is as accurate as to BAPCPA as it was as to S. 220. Given the dearth of filings experienced since BAPCPA became effective on October 17, 2005, and the lack of any empirical data, there is no way to determine whether the new provisions have steered debtors into chapter 13 who otherwise would not have filed a chapter 13. Although some have argued that the reduced number of bankruptcy filings is evidence of the deterrent effect of the new provisions, other explanations are equally plausible. For example, there are reports that some segments of the public believe that after October 15, 2006, bankruptcy simply ceased to exist, and that bankruptcy relief of any kind is now unavailable. This belief might explain the inordinately-large surge of bankruptcy filings on the eve of the effective date of BAPCPA.

Although the reasons for the nature and number of filings is certainly debatable, there is no question that bankruptcy relief is now more difficult to obtain. The new statutes and rules have added eight or more additional paperwork requirements for all consumer debtors, regardless of why they are filing or their circumstances. For example, new Official Form 22A, entitled "Statement of Current Monthly Income and Means Test Calculation (Chapter 7)," contains 57 subparts, the first 15 of which must be completed by all chapter 7 filers. By all reports, these new paperwork requirements have substantially increased the time and expense of representing consumer debtors.

Additional observations and conclusions about the impact of BAPCPA cannot be made until more cases are filed. In the meantime, however, I am gratified that this Subcommittee is keeping a close watch on the bankruptcy system, because all of the elements are in place for a perfect financial storm and a resultant avalanche of bankruptcy filings. The financial state of the average consumer in the United States can only be described as dismal. I am not an economist, but anyone with a modicum of common sense can see that the numbers are as bad as they are unsustainable.

According to the U.S. Census Bureau,[1] in 1989 the median total money income for households in 2005-adjusted dollars was $43,946. In 2005 the median total money income for

[1] U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2005*, p.31 (August 2006), www.census.gov/prod/2006pubs/p60-231.pdf.

households was $46,326–a mere 5 percent increase over 1989. To add to the picture, a recent report from the Federal Reserve Board indicates that between 2001 and 2004 there was actually a 6.2 percent decline in overall median *wage* income.[2]

These income numbers stand in stark relief to the debt numbers. The source for these numbers comes from the Federal Reserve Board's G.19 releases,[3] which set forth the total amount of consumer credit outstanding, *not including loans secured by real estate.* As of December of 1989, total consumer credit outstanding was about $782 billion. As of September of 2005, total consumer credit outstanding was over $2.36 *trillion.* That is over 300 percent of the 1989 debt level. The revolving credit numbers, which would include credit card debt, are even more impressive. As of December of 1989, the total revolving consumer debt outstanding was about $199 billion. As of September of 2005, that number had increased to over $857 billion, or more than 400 percent of the 1989 number.

The data regarding mortgage indebtedness is even bleaker. According to the Federal Reserve, "[o]verall, the median amount of home-secured debt rose 27.3 percent from 2001 to 2004. . . ."[4] The median balance for those borrowing on home equity loans in 2001 was

---

[2] Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances,* p.A5 (February 2006), www.federalreserve.gov/Pubs/Bulletin/2006/financesurvey.pdf.

[3] Federal Reserve Board, *Federal Reserve Statistical Release g.19*, www.federalreserve.gov/releases/g19/.

[4] Brian K. Bucks, *supra* note 2, p. A27.

$16,000. That figure jumped to $22,000 in 2004.[5] In 2004, 15 percent of homeowners who had a mortgage on their house had an adjustable rate mortgage (ARM).[6] One recent report indicates that as of 2006, 22 percent of homeowners had an ARM, and that $1.1 trillion to $1.5 trillion worth of ARMs will re-set in 2007.[7]

Some have suggested that these incredible levels of debt are nothing to worry about, because the value of assets is outpacing the increase in debt. Arguably, that was not the case even when the real estate market was booming, let alone now, when that market is declining. In any event, between 2001 and 2004, the median real value of assets among families rose 10.3 percent, but median net worth rose only 1.5 percent.[8] That is a clear indication that the average American consumer's balance sheet is just as troubled on the asset side as it is on the liability side.

When these numbers are combined with higher energy costs, higher health and education costs, higher minimum credit card payments, and little or no savings, it is no exaggeration to state that a perfect financial storm is in the making. It seems fairly clear that the average American consumer is leveraging his house and other assets to spend more, or to pay off other debts, or simply to make ends meet. When all of the houses have been refinanced up to and beyond their fair market value to pay off all of the credit cards that have reached their limits, and

---

[5] Brian K. Bucks, *Id.* p.

[6] Brian K. Bucks, *Id.* at p.A29.

[7] Brad Finkelstein, *Changing Fortunes,* 8 Broker Magazine No. 11, p. 20 (December 2006), www.sourcemedia.com.

[8] Brian K. Bucks, *supra* at note 2, p.A10.

when all of those cards reach their limits again, the debt bubble will burst. It may not happen next week, or even next year, but basic principles of mathematics dictate that it will happen eventually.

In order for the U.S. economy to weather this coming financial storm, it is essential that we have in place a bankruptcy system that is efficient and readily-accessible so that consumers can reorganize their financial affairs and rehabilitate their balance sheets. One way of increasing the efficiency as well as the predictability of the present system would be to clarify some of the language in BAPCPA.

A great source of frustration for both judges and attorneys is the inability to determine the plain meaning of many of BAPCPA's provisions. A prime example is 11 U.S.C. § 109(h), which requires individual debtors to obtain a credit counseling certificate as a condition to qualifying for bankruptcy relief. Although BAPCPA has been in effect for just over a year, this statute alone has generated over 60 published decisions (and many unpublished ones as well). These decisions are in conflict on a wide variety of issues, such as whether a debtor can meet the eligibility requirement by unsuccessfully seeking credit counseling less than five days prior to filing the petition; whether the certificate must be under oath; whether a case can be "stricken" rather than dismissed for failure to meet the requirement; and whether the facts presented constitute exigent circumstance meriting a 30-day, postpetition extension of the time to obtain the counseling. This plethora of decisions and issues indicates that the language of the statute needs clarification.

Another statute in need of clarification is 11 U.S.C. § 362(c)(3), which deals with limitations on the automatic stay for repeat filers. Judge Thomas Small aptly summarized the problem with this statute in *In re Paschal*, 337 B.R. 274, 277 (Bankr. E.D. N.C. 2006):

> In an Act in which head-scratching opportunities abound for both attorneys and judges alike, § 362(c)(3)(A) stands out. It uses the amorphous phrase "with respect to" a total of four times in short order and raises questions about the meaning of the words "action taken" and "to the debtor." The language of the statute is susceptible to conflicting interpretations, and if read literally, would apply to virtually no cases at all. In sum, it's a puzzler.

This and many other "puzzlers" in BAPCPA should be revamped to avoid further inefficient expenditures of time for both the bench and bar.

An additional way to make the bankruptcy system both more efficient and more accessible would be to eliminate credit counseling as an eligibility requirement, and instead make it a condition of receiving a bankruptcy discharge, as is the case with the financial management instruction course mandated by 11 U.S.C. § 111. Most consumer debtors are hopelessly insolvent well before 180 days prior to filing a bankruptcy petition. Requiring credit counseling at one of the most stressful and confused times in debtors' lives significantly reduces its value, and makes it just another hoop to jump through in order to obtain bankruptcy relief. The consequences of failing to comply with this requirement are not only dismissal or striking of the case, but the loss of the filing fee ($299 in chapter 7 cases, and $274 in chapter 13 cases), something this financially-strapped group of people can ill-afford. It may also create adverse consequences under 11 U.S.C. § 362(C)(3), since it may count as a dismissed case and thus limit the stay in a future filing to just 30 days.

The worthy goals of credit counseling can best be pursued after the debtor has filed his petition, when the pressure from bill collectors has stopped and he can clearly focus on reorganizing his finances. There's no reason why both the credit counseling and financial management courses could not be administered by the United States trustee immediately before or after the § 341 meeting, and at no charge to the debtor.

As a means of reducing the cost of bankruptcy for all parties involved, and in the interests of streamlining the process as well, debtors with current monthly income below the state median family income level should be exempted from having to file some of the documents required by the statute and rules. Under 11 U.S.C. § 707(b)(7), a motion to dismiss under the means-testing provisions of § 707(b)(2) may not be brought by any entity if the debtor's current monthly income is below the applicable state median family income level. Older empirical data indicates that the income of close to 85 percent of all chapter 7 debtors is below the national median household income. Nonetheless, the statute requires debtors to provide the trustee with tax returns, file their pay stubs, and calculate their current monthly income in Official Form 22 , even though that information largely duplicates the information required by Schedule I in Official Form 6. Unless there is some reason to believe that the debtor has not disclosed all income on Schedule C, he should be relieved of these requirements, in keeping with the gist of § 707(b)(7).

Finally, it is important for this Subcommittee and Congress as a whole to monitor the needs of the judiciary, and provide the necessary resources for maintaining and improving the administration of justice in both the bankruptcy courts and the U.S. Courts generally. The recent lull in bankruptcy filings should fool no one into thinking that the present calm will endure. If, as the numbers seem to suggest, there is a debt bubble that is steadily growing, it may explode precipitously and with enormous consequences for the bankruptcy system and the entire Judicial Branch. While additional judgeships and staff may not seem necessary now, we must all be prepared to act quickly to add to the judiciary's ranks if a flood of filings arrives.

The suggestions outlined above are just a fraction of what is needed to prepare the bankruptcy system for any future eventuality. Ideally, all of these ideas and much more could be incorporated into a technical corrections bill, a bill which is sorely needed and which should be addressed sooner rather than later. I can safely speak for all of my colleagues in offering our services and assistance on such a bill in any way this Subcommittee sees fit. Thank you for this opportunity to appear and be heard.

The Wall Street Journal
Bankrupt Opposition
25 October 2006

When President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act last year, Democrats and "consumer" groups not only cried foul but predicted doom. A year after the law was enacted, however, the evidence suggests that their fears were misplaced, not to say cynical.

A modest reform at best, the law was designed to prevent people from having their debts erased regardless of their ability to repay them. Between 1995 and 2004, personal bankruptcies rose 78%. More and more people were running up credit-card and other debt and then seeking Chapter 7 relief, which essentially allowed them to walk away from their obligations.

Under the new law, more of those individuals are required to file for Chapter 13 bankruptcy and submit to a means-tested, court-ordered repayment plan. The law makes exceptions for the poor and elderly, as well as extraordinary cases involving debt that results from medical expenses, military service or divorce.

Not that any of those carve-outs stopped such Democrats as Senator Ted Kennedy from denouncing the reform as "a bill for which the credit-card industry hopes to squeeze an extra few dollars a month out of Americans who are down on their luck." Consumers Union called the legislation a "disaster," and the National Association of Consumer Bank Attorneys said adequate bankruptcy relief would no longer be available to the average person. For the Consumers Union, in particular, this rhetoric fits its pattern of being wrong on nearly every antitrust, consumer finance or telecommunications issue of the day.

Today, the number of bankruptcy filings is down some two-thirds from what it's been in recent years. Partly this has to do with people rushing to file for Chapter 7 before the law took effect last October. But there are also indications that people are responding to the new incentives.

In the past, about 20% of bankruptcy filers have had incomes above the national median. But since the law took effect, nearly all filers are below the median. One plausible explanation is that many past filers were abusing the system. They didn't really need bankruptcy protection, and now that there's a test of their income and assets in place that might compel them to repay their debts, they've decided not to file.

That's good news for businesses and consumers alike. Abuse of the bankruptcy laws drives up the cost of credit for everyone and reduces credit availability at the margin. When people are allowed to exploit the bankruptcy code and burn their lenders, others are left to pick up the tab.

It will probably be another year or so before long-term trends can be projected, and the economy will remain an important factor. But the early returns are promising and show that Congress did the right thing by ignoring the doomsayers.

Bankruptcy's New Era Filings Down Since Law Passed
By Kathleen Day
Washington Post
Tuesday, October 17, 2006; Page D01

Sharon Moore says life "felt like a whirlwind" after her seven-month-old restaurant in Portland, Maine, failed in February.

The 38-year-old single mother said she struggled to find work and keep up payments on a small-business loan and other debts that totaled more than $18,000. Late fees and other penalties sent her finances spiraling out of control.

In July, after working two jobs still didn't make ends meet, she filed for Chapter 13 bankruptcy protection. Under a court-sanctioned plan, her escalating penalty charges are halted, but she must make a fixed payment on her debt each month for the next five years. She can keep her house and car and, by the end, she says, will just about have repaid her obligations. Best of all, she says, "the creditor calls have stopped, and I can breathe again."

Moore is one of an estimated 450,000 people who have sought court protection from creditors since a new law took effect one year ago today that made filing for personal bankruptcy harder and more expensive. While that number may seem high, it is down by about 1 million from the average in the preceding four years.

Lawmakers, consumer advocates and industry executives say that much of the sudden drop in filings after Oct. 17, 2005, can be explained by the fact that 600,000 people filed in the two weeks before the law took effect, a scramble that was 10 times the normal level of filing over 10 business days in recent years.

But the filing rate for the first half of 2006, about 10,000 a week, is well below what could be attributed to last year's mad dash, surprising the lawmakers who wrote the legislation and the industry executives who lobbied for it. "So far, I think it is too soon to make firm judgments," said Sen. Charles E. Grassley (R-Iowa), one of the bill's chief architects.

The legislation, the most significant change to the nation's bankruptcy laws since 1978, was the culmination of a decade-long push by the credit card and auto-financing industries to make it harder for consumers to wipe out debts through bankruptcy. The new law toughened the rules with the intent of steering more debtors into a form of bankruptcy that requires people to repay more of their debts.

Typically, people file for one of two types of bankruptcy: Chapter 7 or Chapter 13. Under Chapter 7 bankruptcy, people can seek cancellation of most of their debts after some of their assets are sold to help creditors. Under Chapter 13, debtors must repay debts under a court-supervised repayment plan, as Moore is doing.

Industry executives had argued that about 10 percent of debtors filing each year for Chapter 7 under the old law, or about 100,000 people, abused the system because they could repay a large portion of their obligations and therefore should be required to do so under Chapter 13. Consumer groups and several lawmakers, mostly Democrats, argued that the number of Chapter 7 filers who misused the system is closer to 3 percent but that, in any case, the new legislation does little to weed them out.

The new law requires people seeking bankruptcy protection to pay higher filing fees and attend mandatory credit-counseling sessions with an accredited firm before and after they file. The goal is to discourage people from filing if they don't have to, and if they do, to pay off as much of their debt as possible.

Ed Yingling, president of the American Bankers Association, which fought hard for the bill, agrees that it's too soon to know the bill's impact but says the first year seems promising. "It seems to be wringing out people who abused the system, and those who really needed to file can do so," he said.

But projections about the long-term trend for bankruptcy filings vary widely. One major credit industry company privately estimates that consumer bankruptcy filings will top 1 million in 2007. The estimate was provided to The Washington Post on the condition that the company not be named because the projection is not public information. That estimate is still far below the 1.5 million in annual filings in the years before the law, though the company also predicts a "slow rate of return to historic levels."

Total filings have started to creep up. Two weeks ago, they hit a weekly rate of 15,000 -- halfway to the 30,000 level that was typical before the new law.

Filings such as Moore's under Chapter 13 may indicate a shift. While the number of total filings is down, the portion that are under Chapter 13 has risen significantly in the last year, accounting for about 40 percent of personal filings, up from 30 percent before the new law took effect.

"It's just too early to draw any grand conclusions," said Samuel J. Gerdano, executive director of the American Bankruptcy Institute, a nonprofit, nonpartisan research group. He said one reason that lower-than-expected filings have persisted is that people might be afraid or misinformed. He has heard of anecdotal evidence that some debt collectors are incorrectly telling consumers that the new bill bars bankruptcies or makes it nearly impossible to file, though no one has studied the matter.

"It's very possible there's consumer misunderstanding about the extent bankruptcy protection's available and at what cost and at what hassle," Gerdano said.

The National Association of Consumer Bankruptcy Attorneys, which has opposed the law from its inception, said a survey of its members shows the new law is "failing on an across-the-board basis," adding little except paperwork and expense.

One part of the law that is being closely watched is a requirement that people seek credit counseling from a nonprofit agency approved by the Justice Department. The Internal Revenue Service earlier this year said it would seek to revoke the tax-exempt status of at least 41 of the nation's largest credit counseling agencies, which account for 40 percent of the industry's revenue, saying the firms appear to be primarily interested in making a profit rather than helping debt-burdened consumers.

The section of the Justice Department that oversees the nation's bankruptcy system is the U.S. Trustee Program. Its budget comes from the fees people and businesses pay to file for bankruptcy, and so far, it's approved 150 credit agencies to provide counseling.

Privately, program officials have expressed dual concerns that if bankruptcies return to former levels, there will be a critical shortage of approved counseling agencies. At the same time, if bankruptcies stay unexpectedly rare, the program may find itself short of operating funds.

Trustee Program spokeswoman Jane Limprecht would only say the program has adequate funding and that there will be sufficient counseling if filings increase.

The National Foundation for Consumer Counseling, which represents many nonprofit firms, yesterday released a survey of its members that found that the industry has been able to handle the volume so far. But the survey also found that a firm's average cost of counseling a person is $50 but that on average it can collect only $40 to pay those costs.

Department of Justice

STATEMENT

OF

CLIFFORD J. WHITE III
DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
U.S. DEPARTMENT OF JUSTICE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT
AND THE COURTS
UNITED STATES SENATE

CONCERNING

"OVERSIGHT OF THE IMPLEMENTATION OF THE
BANKRUPTCY ABUSE PREVENTION
AND CONSUMER PROTECTION ACT"

PRESENTED ON

DECEMBER 6, 2006

Statement of

Clifford J. White III
Director
Executive Office for United States Trustees

"Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act"

Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts
United States Senate

December 6, 2006

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you today to discuss the progress made by the United States Trustee Program to enforce and implement the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The United States Trustee Program (USTP or Program) is the component of the Department of Justice with a mission to enhance the integrity and the efficiency of the bankruptcy system. The BAPCPA imposed significant new responsibilities on the Program, and each of our 95 field offices plays a major role in carrying out the law.[1]

I am pleased to report that the USTP has made significant progress in achieving its goal of making bankruptcy reform work for all stakeholders in the system – debtors, creditors, and the general public. Although it is far too early to determine the long-term impact of the new bankruptcy law, the reforms have been workable and show promising signs for positive results in the future.

[1] The USTP has jurisdiction in all judicial districts, except those in Alabama and North Carolina.

Changing Bankruptcy Terrain

In the wake of the most comprehensive bankruptcy legislation passed in a generation, we have seen a roller coaster in bankruptcy filings. More than 600,000 petitions were filed during the two weeks prior to the October 17, 2005, general effective date of the new law. In the 12 months following October 17th, there were fewer than 500,000 filings. Filings now are trending upward and recently reached about 40 percent of pre-BAPCPA filing rates.

Another change we have seen has been in the mix of chapter 7, chapter 11, and chapter 13 filings. Whereas fewer than 30 percent of all cases were filed under chapter 13 before reform, they now account for about 40 percent of all filings. The number of chapter 11 cases has dipped by more than 20 percent.

These and other data will provide for much academic and practical discussion in the months to come. The United States Trustee Program will continue to review data in the search for information that will help us do a better job of meeting our obligations under bankruptcy reform.

Civil and Criminal Enforcement

The BAPCPA provides new tools for the Program to combat bankruptcy fraud and abuse. One of the reasons we have been able to meet the extraordinary challenges and new responsibilities presented to us by the reform law is that we are building on five years of steady progress realized through our civil and criminal enforcement initiatives. These enforcement efforts reflect a balanced approach to address debtor wrong-doing, as well as to protect consumer debtors who are victimized by attorneys, petition preparers, and others.

In Fiscal Year 2006, we estimate that we took more than 58,000 civil enforcement and related actions, including actions not requiring court resolution, with a monetary impact of more than $878 million in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 220,000 actions with a monetary impact in excess of $2.6 billion. Enforcement actions include such wide-ranging litigation as denials of discharge against debtors who conceal assets and monetary sanctions against attorneys who fail to fulfill their obligations to their debtor clients.

On the criminal enforcement side, we also made much progress in Fiscal Year 2006. Our Criminal Enforcement Unit, which was established within the Executive Office three years ago to assist our field operations in enhancing their criminal referral and law enforcement assistance activities, trained more than 1,500 federal prosecutors and law enforcement personnel, USTP staff, private trustees, and others. The Program increased its number of bankruptcy-related criminal referrals by more than 20 percent, and 25 of the Program's attorneys are now cross-designated as Special Assistant United States Attorneys.

The Department's efforts on the criminal enforcement front were illustrated just a few weeks ago when Deputy Attorney General Paul McNulty announced the conclusion of "Operation Truth or Consequences," a nationwide bankruptcy fraud sweep. In this Operation, United States Attorneys filed criminal charges against 78 defendants in 69 separate prosecutions in 36 judicial districts within the previous two months. Nine lawyers, including bankruptcy lawyers, were among those charged. Eighteen of the charges were filed the day before the announcement.

The charges included concealment of assets ranging from luxury vehicles to a chateau in France; fraud committed against consumer debtors, including mortgage fraud scams that victimized those facing foreclosure on their homes; identity theft; and federal benefits fraud, including a health care fraud case in which Medicaid reimbursements were taken for services never rendered and the proceeds used to purchase a Porsche and other assets that were concealed in the defendant's bankruptcy case.

At the news conference concluding Operation Truth or Consequences, the Department also announced the launch of a new Bankruptcy Fraud Internet Hotline. This Hotline provides a more central mechanism for the public to report instances of bankruptcy fraud. We believe it will be helpful in our efforts to police the integrity of the system.

Bankruptcy Reform

Bankruptcy reform has presented many significant enforcement and implementation challenges. In carrying out our new duties, we reached out to other federal agencies, the private trustees, and creditor and debtor representatives to gain the benefit of their valuable information and insights pertaining to our new tasks. The Program is extremely grateful for the cooperation, advice, and assistance we received.

Under the BAPCPA, the USTP has taken on major new responsibilities in five general areas, which are described below.

Means Testing

Under the new section 707(b), the former subjective "substantial abuse" standard is replaced by a more objective means test formula to determine whether a case is "presumed abusive." In many ways, means testing is the cornerstone of the new bankruptcy reform law.

It is still too early to determine the long-term impact of means testing on the bankruptcy system, but let me suggest two preliminary conclusions. First, means testing is workable. There is a system in place by which debtors can obtain the necessary IRS and Census Bureau information and make required calculations. There is also a system in place for United States Trustee staff to process that information, make a determination of "presumed abuse," and decide whether to bring a motion to dismiss. This success is due in no small part to those in the United States Trustee Program and on the Judicial Conference's Advisory Committee on Bankruptcy Rules who developed the new Official Forms that must be filed in most individual bankruptcy cases.

We cannot draw any firm conclusions about the long-term effectiveness of the means test because the number of filings has been extremely low since the October 17, 2005, general effective date of the reform law. Among other things, we cannot be certain that we will be able to process a larger number of cases with the same efficiency in the future as we have over these past 12 months. My concern about our long-term ability to efficiently process the forms arises largely out of the fact that the courts have not yet mandated "smart forms" with "data tags" that could allow us to automate most of our procedures for the benefit of the United States Trustees, the chapter 7 trustees, and others involved in the process. We are hopeful that in 2007 the Judicial Conference will adopt data tag technology as a mandatory technical standard (with limited exceptions) for petitions and schedules filed electronically.

My second preliminary conclusion is that early data suggest that means testing provides a promising approach to identifying abuse. Of the individual debtors who filed from October 17, 2005, through the end of September, 94 percent were below the median income. Of those above the median, the United States Trustees determined that slightly less than 10 percent were "presumed abusive." Of the presumed abuse cases that did not voluntarily dismiss or convert, United States Trustees filed motions to dismiss in about three-quarters of the cases and declined to file in about one-quarter of the cases. These data suggest that the means test is a useful screening device to identify abusive cases. They also suggest that the statute provides the United States Trustees with sufficient discretion so that decisions on filing motions to dismiss can be made on a case-by-case basis and not solely with reference to the statutory formula.

Credit Counseling and Debtor Education

Another major aspect of bankruptcy reform is financial education. Individual debtors must receive credit counseling prior to filing and debtor education prior to discharge. These are potentially the most far-reaching consumer protection provisions of the Bankruptcy Code. These requirements are designed to ensure that debtors enter bankruptcy knowing what their options are and exit bankruptcy with the tools to avoid future financial catastrophe.

The job of the United States Trustees is to approve providers who meet statutory qualifications to offer credit counseling and debtor education services to debtors. This function was entirely new to the Program and has required enormous effort to carry out effectively.

As with means testing, there are positive signs that the credit counseling and debtor education provisions are workable. The credit counseling industry has been a troubled one, so our first priority was to screen out those who might seek to defraud debtors. We developed our approval and monitoring criteria with enormous assistance from the Internal Revenue Service and the Federal Trade Commission. Our procedures have been praised by those agencies and also by representatives of creditor and consumer groups. In September, to further strengthen our efforts, we commenced post-approval, on-site reviews where we can better verify an applicant's qualifications.

Another important, positive sign is that there is adequate capacity to serve the debtor population,[2] although again, the true test will come when filings reach higher levels, as expected. As of the end of August, we had received nearly 700 initial applications from credit counselors and debtor educators. About 64 percent of those applications were approved, 32 percent were

[2] Pursuant to 11 U.S.C. §§ 109(h)(2)(A) and 727(a)(11), the United States Trustee exempted debtors in the districts most heavily affected by Hurricane Katrina from the credit counseling and debtor education requirements. The exempted districts are the Southern District of Mississippi and the three judicial districts in Louisiana.

either denied or voluntarily withdrawn, and 4 percent were still under review. Moreover, nearly all of the credit counselors and debtor educators who received probationary approval reapplied for a 12-month approval. There are currently 155 approved credit counseling agencies and 285 approved debtor education providers.

In addition to approving the applications of providers, United States Trustees also enforce the requirement that debtors receive credit counseling. Verification should become much easier because of a new Official Form that was approved by the Judicial Conference and became effective on October 1st. The Official Form provides clear notice to individual debtors that they are required to receive pre-petition counseling, unless they qualify for one of the enumerated exceptions.

The USTP is learning more and more every day. We will continue to do an increasingly better job as we gain experience and expertise in carrying out these new duties to enforce and implement the credit counseling and debtor education provisions of the law.

Debtor Audits

The BAPCPA also mandated a new regimen for debtor audits beginning with cases filed on October 20, 2006. The audits will help us to identify cases of fraud and abuse, enhance deterrence, and may provide baseline data to gauge the magnitude of fraud, abuse, and errors in the bankruptcy system.

In FY 2007, we will use contractors to conduct up to 7,000 audits of cases filed by individual debtors. Random audits will be conducted in at least 1 out of every 250 individual chapter 7 and chapter 13 cases filed in a judicial district, and we anticipate between 1,000 and 2,000 audits of cases in which debtors' income or expenses vary greatly from the norm. Our ability to select appropriate cases for non-random audits will be enhanced significantly if the courts agree to adopt data tags for electronic filers.

The procedure for debtor audits will work as follows. Shortly after a case is filed, selected debtors or their counsel will receive a notification of audit and request for documents. We hope that most audits can be completed within 70 days after a debtor's schedules are filed. Reports of the audit results will be filed with the court by the auditors. We will not seek an extension of time to object to discharge based upon a pending audit, except in unusual circumstances, since the statute provides that a discharge may be revoked if the auditor finds a material misstatement not adequately explained or if the debtor does not adequately explain a failure to provide information to the auditor.

Business Reorganizations

The new law made many changes in chapter 11 practice for both small businesses and large corporations. Since October 17th, approximately 950 chapter 11 debtors have indicated they were a small business on their petitions. In the area of small business case administration, we have a mandate to conduct initial debtor interviews soon after a business files a petition; we help enforce the tighter deadlines for filing a disclosure statement and plan of reorganization; and we review a debtor's self-designation as a "small business." Further, we developed a prototype financial reporting instrument which the Bankruptcy Rules Committee has made available for public comment.

While many of the new tools and requirements reflect "best practices" that were followed by USTP offices prior to the BAPCPA, the new provisions provide promising enforcement mechanisms. Among these are the financial reporting requirements of section 1116 and the new deadlines by which businesses must confirm plans of reorganization

The United States Trustees also carry out important new duties in cases involving businesses other than small businesses. In approaching our new responsibilities, we are mindful of the purpose of these provisions. In many respects, the business bankruptcy reforms enhance management accountability and provide greater protections to creditors, shareholders, and the public. The corporate debtor has fiduciary obligations and the right to remain in possession is not unchecked.

Among other things, the law now requires that the United States Trustee seek to oust management if there are "reasonable grounds to suspect" that current management participated in fraud, dishonesty, or other criminal acts in the debtor's management or public financial reporting. In addition, debtors are under stricter time deadlines to confirm a plan of reorganization. They also are restricted in their ability to pay corporate executives large bonuses while lower level employees, shareholders, and creditors face unemployment, devalued pensions, or other economic loss. Moreover, section 1112(b) was amended to lessen the court's discretion in ordering conversion to chapter 7 if the debtor is not expeditiously reorganizing in accordance with the commands of chapter 11.

While, to date, the United States Trustees have been prudent in enforcing the new provisions, we have invoked the "reasonable grounds to suspect" criterion of section 1104(e) in moving for the appointment of a chapter 11 trustee in about 10 cases since enactment of the BAPCPA. We have been successful in about half of them. We also have enforced the executive compensation restrictions contained in the new section 503(c), and have opposed debtors' proposed key employee retention plans in approximately 15 cases.

Studies

The USTP also is required by statute to conduct three studies; these are ongoing. In one study, we have developed and will evaluate a model debtor education curriculum. The model curriculum is currently being tested in six districts, and a report will be issued in September

2007. In another, we will study the utilization of Internal Revenue Service expense standards for determining current monthly expenses under the means test. That report will consider the impact of using the IRS standards and identify issues that have arisen during the first year of implementation. The report will be issued in April 2007. The final required study will examine the impact of the new household goods definition in the Bankruptcy Code, and may help identify changes in the number of lien avoidance actions taken. The report is due in April 2007. Both the means testing and household goods studies are hampered, to an extent, by the lack of data tagging or equivalent software that would make it easier for researchers to identify cases and aggregate information contained on filed financial statements.

In addition to the required studies, the Program also is exploring special issues associated with credit counseling delivered via the Internet. We have contracted with a research firm to report back to us on their conclusions within the next few months.

Other New Duties

Beyond these five major areas, the United States Trustee Program has also carried out many other important new duties, such as appointing privacy and patient care ombudsmen and litigating many issues of first impression. For example, we have assisted the Civil Division in its defense of the debt relief agency provisions of the reform law, we have filed numerous briefs in defense of the right of chapter 13 debtors to make continued charitable contributions, and we have vigorously asserted our position on many disputed matters pertaining to the application of the means test in both chapter 7 and chapter 13 cases. We also continue to collaborate very closely with the Judicial Conference's Advisory Committee on Bankruptcy Rules.

Conclusion

The new bankruptcy reform law has presented many challenges to the United States

Trustee Program. I am extremely proud of the diligence and professionalism which Program officials in headquarters and in the field have shown since passage of the new law. Their extraordinary efforts, extremely hard work, and fidelity to the law have allowed us to make substantial progress. We look forward to continuing our efforts in the future to make bankruptcy reform work for debtors, creditors, and the general public.

# # #

TESTIMONY OF PROFESSOR TODD J. ZYWICKI

GEORGE MASON UNIVERSITY SCHOOL OF LAW

3301 N. Fairfax Dr.
Arlington, VA 22201
703-993-9484

Presented to the Hearing of the
Administrative Oversight and the Courts Subcommittee of the
Judiciary Committee of
United States Senate

"Oversight and The Implementation of the
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005"

Mr. Chairman and Honorable Senators:

It is my pleasure to testify today on a one-year retrospective on the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). BAPCPA was enacted last year to address two decades of rising consumer bankruptcy filing rates and rising concerns about the presence of fraud and abuse in the consumer bankruptcy filings system. BAPCPA was enacted by broad bipartisan majorities in both houses of Congress and after nearly eight years of hearings and consideration by Congress.

The goals of BAPCPA were twofold: to preserve bankruptcy relief for those who need it while reducing fraud and abuse of the bankruptcy system by those who do not. I understand the purpose of today's hearing to be to address whether BAPCPA has succeeded in realizing these two goals. We have had only one year of experience with BAPCPA, of course, so any judgment rendered today necessarily must be tentative. Nonetheless, one year (now 13 months) does provide an opportunity for some examination of trends and experience with the new legislation to determine whether progress is being made in the directions sought be Congress in enacting BAPCPA.

BAPCPA was designed to address a fairly obvious problem. Over the past three decades, consumer bankruptcy filings in the United States skyrocketed (*see* Figure 1 attached), surmounting 1.5 million in 2004. This rise in bankruptcy filing rates was during one of the most economically prosperous periods in American history, an era of economic growth, low interest rates, record wealth accumulation, and low unemployment. *See* Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NORTHWESTERN L. REV. 1463 (2005), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=587901. Given this anomaly and the inability for underlying economic problems to explain the rise in filings, it appears that among the major reasons why bankruptcy filings rose during this period was the economic incentives created by the bankruptcy system itself, which provided substantial incentives to file bankruptcy while providing few safeguards against fraud and abuse. *See* Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASHINGTON & LEE L. REV. 1071 (2005), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=681483. Other factors appear to include changing social norms or "stigma" regarding bankruptcy as well as changes in the nature of consumer credit toward more national and impersonal forms of credit. *Id.*

In the mid-1990s Congress authorized the establishment of the National Bankruptcy Review Commission to study the American bankruptcy laws and issue proposals for reform. The NBRC, however, failed to address the problems of rising bankruptcy fraud and abuse. Beginning in the late-1990s, therefore, Congress set off on a multiyear project to enact needed reforms to the bankruptcy laws, finally culminating in the enactment of BAPCPA in April 2005, with an effective date of October 2005. Any lingering questions about whether bankruptcy filers do in fact respond to the incentives of the bankruptcy laws or have an opportunity to control the timing and necessity of their bankruptcy filings was largely put to rest in the period preceding BAPCPA's effective date, as over half a million Americans filed bankruptcy during those two weeks.

Based on the evidence and anecdotal reports that I have heard, early returns suggest that BAPCPA has been a substantial success in preserving bankruptcy relief for those who need it while reducing fraud and abuse.

Preserving Relief for Those Who Need It

BAPCPA has not provided a major obstacle to needy and deserving filers getting bankruptcy relief. Critics of the legislation predicted widespread hardship and duress if BAPCPA was enacted. Critics argued that BAPCPA would harm victims of hurricanes and other natural disasters by interfering with their ability to gain needed bankruptcy relief. Critics argued that BAPCPA would erect barriers to bankruptcy discharge and somehow harm women and children's efforts to collect alimony and child support by putting them in competition with general unsecured creditors.

These criticisms have turned out to be largely unfounded.

First, there is no evidence that BAPCPA has provided a major obstacle to needy and deserving filers from gaining bankruptcy relief. Anecdotal evidence suggests that the cost of bankruptcy relief has increased post-BAPCPA, especially lawyers' fees. This increased cost was to be expected, as the increased accountability in the bankruptcy system and new regulations on low-cost, abusive "bankruptcy mills" would be expected to raise the cost of bankruptcy proceedings. Prior to BAPCPA, compliance with the bankruptcy laws was largely on the "honor system," predicated on voluntary debtor disclosure and cooperation. Were human nature otherwise than it is, the honor system might have worked in bankruptcy cases. But just as we learned that the honor system doesn't work when it comes to paying taxes, preventing Medicare fraud, or crime, experience taught that increased accountability was necessary in bankruptcy. And just as the presence of the IRS raises the cost of filing tax returns, the increased accountability in bankruptcy cases may have raised the cost of bankruptcy filings. Time will tell whether this increased accountability has been worth the increased cost. For the time being, however, there seems to be little evidence that this increased cost has meaningfully interfered with the ability of those who need bankruptcy relief from gaining it.

Second, BAPCPA has proven itself flexible enough to deal with major economic problems, such as hurricanes or other natural disasters. In many areas BAPCPA makes judicial decision making more "rule-bound" and channels judicial discretion in a more focused manner than in the past. But BAPCPA reserves sufficient discretion to deal with unanticipated contingencies, such as the Hurricane Katrina disaster that hit just as BAPCPA was going into effect. The United States Trustee exercised its power to waive some requirements that were impractical in light of Katrina's devastation and courts and lawyers have acted with alacrity. I am aware of no complaints of widespread lack of access to the bankruptcy courts following Katrina. Moreover, additional experience with BAPCPA will almost certainly increase the expertise of bankruptcy professionals and judges to respond to similar disasters in the future.

Third, critics stated that BAPCPA somehow would have the unintended consequence of making it harder to collect spousal support obligations post-bankruptcy by increasing the amount of debt that was nondischargeable. This argument was dubious in the first place and seems to have been based on fundamental misunderstanding of the rules governing debt collection outside bankruptcy and the priorities of different types of creditors. *See* Todd J. Zywicki, *"Support Creditors" Under Bankruptcy Reform Law*, THE VOLOKH CONSPIRACY (Nov. 17, 2005), http://volokh.com/posts/1132237519.shtml. Regardless, I am aware of no reports that BAPCPA has created any new problems on this front. Instead, it appears that BAPCPA has done exactly what it was intended to do, namely to increase the ability of spousal support creditors to pursue their claims in bankruptcy without the obstruction of the Bankruptcy Code.

Thus, the overall record to date indicates that BAPCPA has preserved bankruptcy relief for those who need it, even in situations of severe stress, such as with Hurricane Katrina.

Reducing Bankruptcy Fraud and Abuse

The record also indicates that BAPCPA has substantially reduced bankruptcy fraud and abuse. The decline in filing rates is impressive (*see* Figure 2, attached). Immediately following the surge of filings in October 2005 was a dramatic drop in filing rates, as many of those who filed in October did so strategically in order to beat the change in the law. Filings have gradually begun to rise again, but remain at less than half of their pre-BAPCPA rate. Moreover, weekly filings have remained largely constant for approximately eight months. This lack of any discernible upward trend is especially surprising given certain events in the economy that might be expected to exert upward pressure on bankruptcy filing rates, such as a general rise in interest rates (especially by causing an upward tick in adjustable-rate loans), stagnant housing prices, and new regulations imposed by the Federal Reserve in January that increased the mandatory minimum payment on credit card loans. All of these factors would be expected to increase bankruptcy filing rates, yet filing remain down and constant. Nor am I aware of any evidence of any substantial rise in nonbankruptcy delinquencies or defaults as would be expected if consumers in need of filing bankruptcy yet were unable to do so.

BAPCPA sought to attack the problem of bankruptcy fraud and abuse through several of well-targeted reforms that try to eliminate fraud and abuse where most present while leaving good-faith filers unaffected. Based on the limited information we have to date it appears that these many reforms have generally succeeded in weeding out abusive filers while leaving the basic integrity of the system intact. The dramatic drop in bankruptcy filing rates suggests that these reforms have done so by deterring fraudulent debtors from filing bankruptcy or by redirecting debtors to nonbankruptcy alternatives. Each of these targeted reforms may be responsible individually for diverting only 5-10% of debtors away from bankruptcy; cumulatively, however, they may account for the substantial drop in bankruptcy filing rates.

Anecdotal reports suggest that the following reforms imposed by BAPCPA may explain the decline in fraudulent and abusive filings:

- Fraud: BAPCPA created a host of new rules and procedures to attack the problem of bankruptcy fraud, such as requiring filing of tax returns, pay advices, and other information to make it easier to detect and pursue fraud. Increased efforts by USDOJ to prosecute bankruptcy fraud, such as "Operation Truth or Consequences," may have also contributed to a decrease in fraudulent filing. These new tools likely have deterred many fraudulent filers from filing.
- Abuse: Through the system of means-testing eligibility for Chapter 7 relief, BAPCPA requires those debtors who earn above the state median income and can repay a substantial portion of their unsecured, nonpriority debt to do so in Chapter 13. I am aware of no comprehensive data on the

effects of means-testing so far. Nonetheless, it appears that at least some high-income debtors with repayment capacity who would have filed bankruptcy in the past are now choosing not to file bankruptcy, but rather to repay their debts in some other way. Early evidence suggests that Chapter 13 filings have risen as a percentage of bankruptcy filings (rising from approximately 30% to 40-45%), suggesting that means-testing may be pushing some filers into Chapter 13. Some critics charged that pushing debtors into Chapter 13 would be unwise, given the high failure rate of Chapter 13 plans. Based on the evidence that I have seen and anecdotal reports, despite the rise in Chapter 13 filings as a percentage of cases there has been no discernible increase in the Chapter 13 dismissal rate. Any verdict on the impact of means-testing is tentative, given the sharp drop in overall filings; nonetheless, experience to date is consistent with Congress's goals in imposing means-testing.

- Repeat Filings: BAPCPA sought to reduce bad-faith repeat filings in several ways, such as by extending the time between eligibility for Chapter 7 discharge and by streamlining the process for creditors to gain relief from the automatic stay for repeat filings. I am aware of no systematic evidence on changes in the volume of repeat filers post-BAPCPA., but pre-BAPCPA research indicated that the number of repeat filers in bankruptcy was substantial. Anecdotal reports suggest that there has been a substantial reduction in the number of repeat filers.

- Cramdown: BAPCPA limits the ability to cramdown certain secured consumer debts, most typically auto loans. It may be that fewer debtors are availing themselves of bankruptcy because of this reduced ability to cramdown auto loans. This seems somewhat unlikely and is contradicted by the increased fraction of Chapter 13 cases as a percentage of all cases filed.
- Domestic Support Creditors: Pre-BAPCPA law provided several loopholes for those seeking to discharge certain domestic support obligations or to gain the benefit of the automatic stay to frustrate their collection. This gamesmanship and abuse appears to have disappeared under BAPCPA, likely deterring at least some debtors who would have filed bankruptcy for this improper purpose.
- Consumer Credit Counseling: One of the more controversial aspects of the new law has been the requirement of pre-bankruptcy consumer credit counseling and the completion of a financial management class as a condition for discharge. Reports suggest that some debtors have been redirected into debt-management plans and away from bankruptcy by this requirement. The requirement that debtors complete a financial management class as a condition for discharge is intended to reduce filings in the long run. It is too early to tell how effective this requirement will turn out to be.
- Changing Social Norms: It may also be that BAPCPA, and the widespread publicity it received, may have had the effect of changing social norms

regarding the social acceptability of bankruptcy. It may be that one effect of BAPCPA was to help reassert values of thrift and personal financial responsibility while reasserting some of the social "stigma" associated with filing bankruptcy. Many believe that law has this "expressive" function of changing social norms. These effects are difficult to measure or demonstrate, but may be present in the current case.

A final factor that has likely led to a decrease in bankruptcy filing rates has been general misunderstanding among the public about the effects of BAPCPA. Anecdotal reports indicate that many consumers believe that bankruptcy relief is no longer available or is now intolerably onerous. This is untrue, of course. In large part, this misinformation appears to have been spawned by agenda-driven media reports and some bankruptcy experts who actually sought to create this misimpression in an attempt to try to build public opposition to bankruptcy reform. These efforts were both unsuccessful and irresponsible. Nonetheless, a public impression remains that bankruptcy is no longer a viable option. This has likely led to a temporary dampening of bankruptcy filing rates. As day follow the night, bankruptcy professionals have now changed their tune and recent advertising by bankruptcy professionals stress that bankruptcy relief is still available to those who need it. It is likely that over time this misimpression about the law will erode and that the contribution of this effect to lower filing rates will prove temporary.

Overall, the record to date indicates that Congress has effectively targeted bankruptcy fraud and abuse through the various reforms enacted in BAPCPA.

Remaining Areas for Improvement

Experience to date thus suggests that BAPCPA has been quite successful in accomplishing its primary goals of preserving bankruptcy relief for those who need it while reducing bankruptcy fraud and abuse. On the other hand, there several minor "glitches" in drafting and implementation of the statute have been reported, where statutory language has been ambiguous or less than artfully drafted. Ambiguities are to be expected in any complex statutory reform, whether of the bankruptcy code, tax code, Medicare reform, campaign finance reform, or any other comprehensive federal law. BAPCPA appears to be no more prone to these ambiguities than other similar legislation. The questions that have arisen under BAPCPA, for instance, appear to be minor when compared to some of the major constitutional and statutory interpretation issues that arose under the 1978 Bankruptcy Code, the last previous overhaul of the bankruptcy laws. In *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the United States Supreme Court struck down as unconstitutional the entire structure of the judicial system created under that legislation. Although some minor constitutional questions have arisen under BAPCPA related to the First Amendment and client counseling issues, BAPCPA does not appear to raise the profound constitutional infirmities of the 1978 Code. Indeed, litigation continues to this day as courts construe the linguistic ambiguities contained in the 1978 Code. Over the past two decades the Supreme Court has confronted a steady stream of litigation involving interpretation of the Bankruptcy Code covering almost every important area of consumer bankruptcy practice, from the calculation of the proper cramdown interest rate in a Chapter 13 plan, to the valuation of collateral in a Chapter 13 plan, to the meaning of "willful and malicious injury" for purposes of nondischargeability. Indeed, just last month the United States Supreme Court heard oral arguments in *Maramma v. Citizens National Bank of Massachusetts*, a case raising a question of statutory interpretation of the 1978 Code on the question of whether a judge can prohibit a bad-faith conversion of a debtor's case from Chapter 7 to Chapter 13.

Moreover, my review of the extant caselaw interpreting BAPCPA indicates that in most cases where the statutory language is inartfully drafted courts have been able to readily discern Congress's intent and to make sense of the statute in light of that intent. Ambiguities remain and I would urge this body to consider technical amendments at some point in the future to clarify some nagging questions of construction. Nonetheless, BAPCPA's flaws have proven to be relatively minor by the standards of prior bankruptcy legislation. Unlike the 1978 Code, however, there appears to be no major constitutional flaws in BAPCPA nor insoluble questions of statutory interpretation fundamentally different from those raised by the 1978 Code. In addition, BAPCPA provides for interlocutory appeal to the Federal Courts of Appeals to resolve contested issues of law, which should resolve lingering ambiguities and uncertainties more rapidly than in the past.

Conclusion

As BAPCPA passes its one year anniversary, experience to date suggests that it has been largely successful in accomplishing its stated and worthwhile goals. It appears to have preserved bankruptcy relief for those who need it while reducing fraud and abuse in the system. One year is plainly too early to render a final verdict on the reforms and further empirical analysis will be necessary to determine whether the reforms are effective in accomplishing their goals in the long run. Nonetheless, after one year BAPCPA appears to be on the right track.

Figure 1

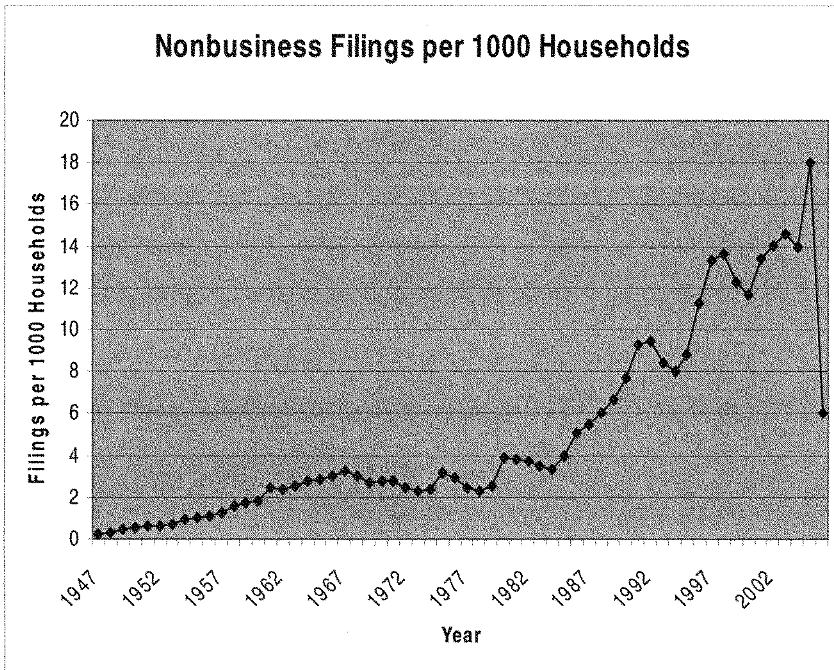
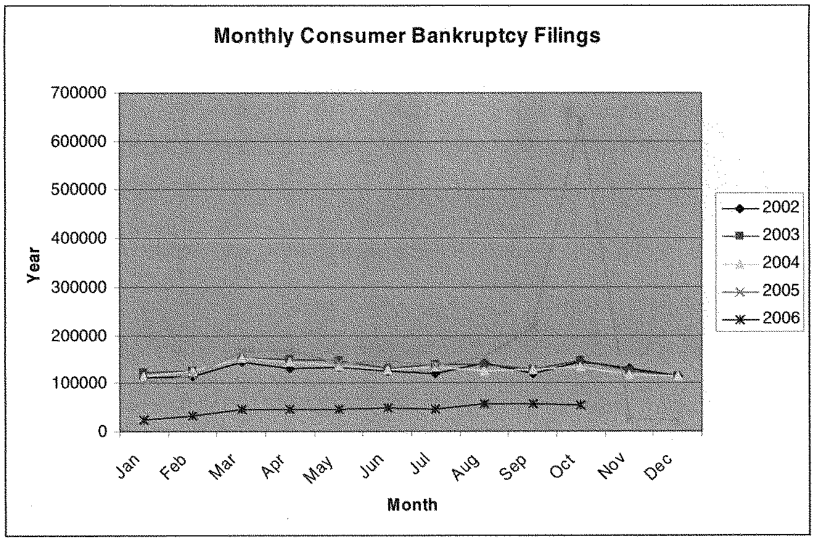

Nonbusiness Filings per 1000 Households
Filings per 1000 Households
20
18
16
14
12
10
8
6
4
2
0
1947
1952
1957
1962
1967
1972
1977
1982
1987
1992
1997
2002
Year

Figure 2


Monthly Consumer Bankruptcy Filings
700000
600000
500000
400000
300000
200000
100000
0
Year
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Month
2002
2003
2004
2005
2006